No. 12309.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

In the Matter of

CALIFORNIA ASSOCIATED PRODUCTS CO., a corporation, doing business as YANKEE DOODLE ROOT BEER BOTTLING COMPANY,

Bankrupt.

WIL-RUD CORPORATION,

Appellant,

vs.

R. A. LYNCH, *et al.*,

Appellees.

APPELLANT'S OPENING BRIEF.

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Introductory Statement.

This is an appeal by Wil-Rud Corporation, a party aggrieved, from a certain Order of the United States District Court, Southern District of California, Honorable Ben Harrison, Judge presiding, entered on May 26, 1949, granting the Petition for Review of Aaron Levinson, Bank of America, National Trust and Savings Association, Leo Brill, F. W. Boltz Corporation, and Victor Kramer, and reversing the Order of Referee Approving Compromise, dated February 26, 1948, wherein the Referee had approved a compromise between E. A. Lynch, Receiver, and Wil-Rud Corporation.

Appellant, Wil-Rud Corporation, is the purchaser of certain assets of the bankrupt from the Receiver, free

and clear of all liens, incumbrances, and charges, at a sale held in open Court before the Referee on October 15, 1947. By the terms of the Order of Confirmation of Sale the payment of the purchase price of $161,000.00 was to be made concurrently with the delivery of the assets by the Receiver to the purchaser, Wil-Rud Corporation. Thereafter, appellant, Wil-Rud Corporation, asserted that all the assets purchased were not delivered to it by the Receiver, and that certain of said assets so purchased were not free and clear of all liens, incumbrances, and charges. This caused a controversy between Wil-Rud and the Receiver, and a hearing was had before the Referee who indicated that he would uphold the claims of Wil-Rud. As a result considerable negotiations were had between Wil-Rud and the Receiver culminating in the filing, by the Receiver, of a Petition for Leave to Compromise Controversy. After due notice, a hearing upon said petition was held before the Referee who made an order approving the compromise, by which, among other things, Wil-Rud was allowed a credit of $18,500.00 upon the purchase price.

The appellees, Aaron Levinson, Bank of America, National Trust and Savings Association, Leo Brill, F. W. Boltz Corporation, and Victor Kramer, are unsecured creditors of the bankrupt. They filed a Petition for Review of the Referee's order approving the compromise, and on May 26, 1949, an order of the District Court was entered granting the said Petition for Review and reversing the Referee's order approving the compromise.

The District Court not only reversed the Referee's approval of the compromise, *but went much further and attempted to and purportedly did determine on the merits the actual controversy between Wil-Rud and the Re-*

ceiver, which was the subject matter of the disputes between them, thereby depriving Wil-Rud of its day in Court on the merits of said disputes. This the District Court could not do upon the *Petition for Review. It could either approve or reject the compromise; it certainly could not determine the merits of the disputes between Wil-Rud and the Receiver upon such petition.*

Appellee, E. A. Lynch, is the Receiver and Trustee of said bankrupt. He has not appealed from the aforesaid Order of the District Court, but has been named as an appellee herein, as his rights and interest in the matter will be materially affected by the determination of this appeal.

Statement of Jurisdiction.

1. The statutory provisions believed to sustain the jurisdiction of the District Court are as follows: U. S. C. A., Title 11, Section 1, subdivision 10, as amended, providing that ". . . courts of bankruptcy shall include the District Courts of the United States . . ." (Bankruptcy Act, Sec. 1, sub. 10);[1] U. S. C. A., Title 11, Section 11, subdivision (a), as amended, providing that "The courts of the United States hereinbefore defined as courts of bankruptcy are hereby created courts of bankruptcy and are hereby invested, within their respective territorial limits . . . with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under this title . . ." (Bankruptcy Act, Sec. 2); U. S. C. A., Title 11, Chapter 11, Sections 701 to 799, as amended, entitled, and providing for "Arrangements," meaning ". . . any plan of a debtor for the set-

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[1]All references to the Bankruptcy Act refer to the Chandler Act, as amended.

tlement, satisfaction, or extension of time of payment of his unsecured debts upon any terms; . . ." (Bankruptcy Act, Chap. XI, Secs. 301 to 399); U. S. C. A., Title 11, Section 50, as amended, providing "The receiver or trustee may, with the approval of the court, compromise any controversy arising in the administration of the estate upon such terms as he may deem for the best interests of the estate." (Bankruptcy Act, Sec. 27); U. S. C. A., Title 11, Section 67c, as amended, providing that "A person aggrieved by an order of a referee may, . . . file with the referee a petition for review of such order by a judge . . ." (Bankruptcy Act, Sec. 39c.)

2. The existence of jurisdiction of the District Court is shown by the following pleadings:

(a) Petition for Plan of Arrangement under U. S. C. A., Title 11, Chapter 11, as amended (Chap. XI, Bankruptcy Act) filed on July 29, 1947, by California Associated Products Co., a corporation, doing business as Yankee Doodle Root Beer Bottling Company, as the then debtor, in the District Court of the United States, Southern District of California, Central Division, in that certain proceedings entitled, "In the Matter of California Associated Products Co., a corporation, doing business as Yankee Doodle Root Beer Bottling Company, Debtor," No. 45137-BH. By said petition the aforesaid debtor sought an Arrangement with its creditors under the provisions of Chapter XI of the Bankruptcy Act. [R. 179.]

(b) An Approval and Order of Reference on July 29, 1947, was made by said District Court in the aforesaid matter, and the said matter was referred for all purposes to Referee Hugh L. Dickson. [R. 179, par. 2.]

(c) A Petition for Leave to Compromise was filed January 6, 1948, before the Referee, by Receiver, seeking

to compromise the controversy existing between Receiver and Wil-Rud Corporation. [R. 12-16.]

(d) Notice of Hearing of Petition to Compromise and Sale of Accounts Receivable was given to all of the creditors, setting forth the time and place of the hearing, and the terms of the proposed compromise. [R. 16-19.]

(e) Written Findings of Fact, Conclusions of Law, and Order Approving Petition for Leave to Compromise Wil-Rud Corporation Sale were duly made and filed on February 26, 1948, by the Referee, and by said Order the compromise set forth in the aforesaid petition was approved, and Wil-Rud Corporation was allowed a credit of $18,500.00 upon the purchase price of assets previously purchased by it from the Receiver. [R. 20-24.]

(f) Petition for Review of Referee's Order dated February 26, 1948, by Judge, was filed with the Referee on March 8, 1948, by appellees, Aaron Levinson, Bank of America, National Trust and Savings Association, Leo Brill, F. W. Boltz corporation, and Victor Kramer, to review the Order of the Referee approving said compromise by the District Judge. [R. 25-28.]

(g) Order of the Referee filed April 26, 1948, adjudicating the debtor a bankrupt after the Plan of Arrangement had failed. [R. 180, par. 3.]

(h) Written Findings of Fact, Conclusions of Law, and Order Granting Petition for Review and Reversing Order of Referee Approving Compromise were filed by the District Judge on May 24, 1949, and said Order was entered and docketed on May 26, 1949. [R. 44-48.]

(i) By Order of the District Judge, permission was granted to the Wil-Rud Corporation to appear and file a brief in connection with the Petition for Review and the hearing thereon. [R. 44.]

3. The statutory provisions believed to sustain the jurisdiction of the United States Court of Appeals for the Ninth Circuit are as follows: U. S. C. A., Title 11, Section 47, subdivision (a), as amended, providing "The Circuit Courts of Appeal of the United States . . . are hereby invested with appellate jurisdiction from the several courts of bankruptcy in their respective jurisdictions in proceedings in bankruptcy, either interlocutory or final, and in controversies arising in proceedings in bankruptcy to review, affirm, revise or reverse, both in matters of law and in matters of fact . . ." (Bankruptcy Act, Sec. 24a); U. S. C. A., Title 11, Section 47, subdivision (b), as amended, providing "Such appellate jurisdiction shall be exercised by appeal and in the form and manner of an appeal." (Bankruptcy Act, Sec. 24b); U. S. C. A., Title 11, Section 48, subdivision (a), as amended, providing "Appeals under this title to the Circuit Court of Appeals of the United States . . . shall be taken within thirty days after written notice to the aggrieved party of the entry of the judgment, order or decree complained of, . . . or if such notice be not served and filed, then within forty days from such entry." (Bankruptcy Act, Sec. 25, sub. a.)

The existence of jurisdiction of the Court of Appeals is shown by the following:

(a) The Order of the District Judge granting the Petition for Review and reversing the Order of Referee Approving Compromise was entered and docketed on May 26, 1949. [R. 48.]

(b) The Notice of Appeal from the aforesaid Order of the District Court was filed by appellant with the Clerk of the District Court on June 21, 1949. [R. 49.]

(c) Concurrently with the filing of the Notice of Appeal, to-wit, on June 21, 1949, appellant filed with the Clerk of the District Court a Bond for Costs on Appeal as required by law. [R. 180, sub. 14.]

Statement of the Case.

A. The Pleadings and the Issues.

1. The Order Confirming and Approving Sale.

On October 22, 1947, the Referee signed and filed an Order confirming and approving the sale of certain assets by the Receiver to Wil-Rud Corporation. Said Order was made a part of the Referee's Certificate on Review. [R. 35]. Since the controversy involved stems from said sale, the pertinent portions of said Order become important. The following are the material terms thereof:

> "Now, Therefore, the undersigned Referee does hereby approve and confirm the sale by E. A. Lynch, as Receiver in the within estate, of certain personal property, hereinafter described, to Wil-Rud Corporation, a corporation, for a cash consideration to be paid to said E. A. Lynch, as Receiver, in the sum of $161,000.00, *delivery of the assets to be made upon the signing of the within order, and payment therefor to be made concurrently with delivery to the buyer.*[2]
>
> "1. The Receiver, by this order, is deemed to have sold, and does sell to the buyer, all machinery, fixtures, equipment, *all inventory,*[3] all lessee's improvements, all furnishings, all supplies, and all finished and unfinished products of every class and character and description whatsoever located at 3631 Union Pacific Avenue, Los Angeles, California, *together with all the other physical assets of the debtor corporation, wheresoever situated,*[4] and together with all of the physical assets of every class and character of the Yankee Doodle Root Beer Company, a corpo-

ration, as of December 15, 1947, at 5:00 o'clock P. M.; *all of said items are sold free and clear of any liens, charges, and encumbrances,*[5] save and except a balance owing on a sales contract to the Los Angeles Water Softener Company in the sum of $1,699.17, which balance the purchaser assumes and agrees to pay." [R. 3-4.]

The Order further provided for the transfer by Receiver to buyer of all right, title and interest of the estate in and to a certain lease, together with any arrangement or understanding which certain officers of the debtor may have had with the owner for any extension thereof, or for any new lease; said Order also transferred to buyer all issued and outstanding shares of capital stock of Yankee Doodle Root Beer Company, and all ownership, right, title and interest of the estate in and to patents, processes, formulae, good will, copyright, trade names, trade marks, royalties, licensing agreements. The last provision excluded certain assets from the sale, none of which are involved herein. [R. 4-7.]

It is apparent that the terms of the aforesaid Order made payment of the purchase price by buyer *concurrent* with the delivery to it of the assets, and included, among the assets sold, *"all inventory,"* and "all the other physical assets of the debtor corporation, *wheresoever situated."*

2. Petition for Order to Show Cause re Wil-Rud Corporation Sale.

Upon the signing of the Order of Confirmation, Wil-Rud paid the Receiver $100,000.00, and certain assets were delivered to it. Wil-Rud, however, claimed that all assets purchased were not delivered to it, and that its obligation

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2, 3, 4 and [5]Italics ours.

to pay the purchase price, by the terms of said Order, was conditioned upon receipt of the assets purchased.

On October 31, 1947, the Receiver filed the aforementioned petition to recover the balance of the purchase price. This petition also was attached to the Referee's Certificate on Review. [R. 35.]

The Receiver alleged the sale on October 15, 1947, and the confirmation thereof by written Order on October 22, 1947. That $100,000.00 of the purchase price was paid, and that $61,000.00 remained unpaid; that Wil-Rud desired an adjustment thereof in that, based upon an inventory prepared by Receiver, certain items of personal property were missing, valued at $15,488.99, and that errors existed in the inventory in the sum of $3,463.17, making a total difference claimed of $18,952.16. The Receiver then alleged that all assets sold were tendered to purchaser; that the $61,000.00 was due without any allowance of offsets, in that the sale was not predicated upon the inventory, but was made solely in accordance with the Order confirming the sale. [R. 8-9.]

3. Petition for Leave to Compromise re Wil-Rud Corporation Sale.

The proceedings directly involved in this appeal begin with the aforementioned Petition for Leave to Compromise filed by the Receiver on January 6, 1948, with the Referee. Receiver therein alleged that on October 15, 1947, Wil-Rud Corporation purchased certain assets for $161,000.00; that certain differences arose between purchaser and Receiver; that the purchaser contended that it bought all those physical assets reflected by a certain inventory filed in the Debtor Proceedings, being Respondent's Exhibit No. 2, introduced by Receiver at the hearing

before the Referee on November 7, 1947. That at this hearing, Wil-Rud Corporation contended that it was entitled to an adjustment on inventory shortages in the sum of $19,336.86. That subsequent thereto, Wil-Rud Corporation presented additional claims, based upon page 88-a of said inventory, itemizing a total of $47,976.29 worth of root beer bottles and cases alleged to be in the vicinity or territory of Los Angeles, California; that the debtor had taken deposits of 60 cents per case from its customers, who by virtue of possession of the cases and bottles had a lien thereon until the 60 cents was repaid; that purchaser had other claims, contending that it paid warehouse and other charges on items purchased free and clear.

The petition stated Receiver contended that the assets were sold "where is, as is" as of October 15, 1947, but that there was merit to the Wil-Rud's claims, since the issues as to the inventory shortages had been submitted, to the Referee on November 7, 1947, and that at said hearing the Referee had indicated that he would determine that matter in favor of purchaser.

The petition then alleged that after a full and complete inter-change of facts, numerous conferences and negotiations, a compromise and settlement was offered by Wil-Rud, which was recommended by the Receiver as being for the best interests of the said estate, as follows:

(a) That a credit of $18,500.00 would be allowed upon the purchase price, making the same $142,500.00, and leaving a balance of $17,500.00 thereon, which purchaser would pay upon approval of the compromise.

(b) That purchaser offered to buy certain outstanding accounts receivable, and agreed to hold Receiver free and harmless of refunds up to 60 cents per case, containing twenty-four bottles, surrendered to the purchaser.

(c) That all claims of every kind, nature and character which either Receiver or Wil-Rud had against the other, would be settled.

The prayer requested that due notice to creditors be given; that a hearing be had, and that the said compromise be approved. [R. 12-16.]

4. Notice of Hearing on Petition to Compromise.

This notice stated that a meeting of the creditors would be held on January 29, 1948, at the Referee's Court Room to hear the petition of the Receiver to compromise, and set forth therein the dispute, the various contentions in respect thereto, and the terms of the proposed compromise. [R. 16-19.]

5. Findings of Fact, Conclusions of Law, and Order Approving Petition to Compromise.

After a hearing, the Referee approved the compromise, excluding therefrom the accounts receivable, and on February 26, 1948, made and filed his Findings of Fact, Conclusions of Law, and Order. The Referee found as true the appointment and qualification of the Receiver; that a controversy existed between Receiver and Wil-Rud and that their contentions were as set forth in the petition; that Wil-Rud Corporation could reasonably contend that it was entitled to an adjustment of $28,000.00; that it was for the best interests of the estate to permit the compromise of the pending matters, and other claims by allowing a reduction of $18,500.00 on the purchase price, thereby reducing the same to $142,500.00, and leaving a balance of $17,500.00 due and payable. That certain of the objecting creditors (constituting some of appellees herein) had approved a bid of $135,000.00 and had submitted it to the Court on October 15, 1947, and requested

the Court not to accept any higher bids. That on November 7, 1947, the Court had considered the claims of Wil-Rud Corporation concerning shortages, and had indicated from the bench that it appeared from the evidence that the purchaser had relied upon the inventory prepared in said estate and therefore was entitled to pro rata credits for the shortages in the inventory. That as a part of said compromise, purchaser, Wil-Rud Corporation, was to hold the Receiver harmless for any refunds on cases up to 60 cents per wooden case containing twenty-four bottles. That upon payment of the $17,500.00, all claims of Wil-Rud Corporation and Receiver as against the other arising from said sale would be compromised and settled in full. That it would be an unwise expense to direct the Receiver to quiet the title of the many hundred retailers with whom the Debtor had dealt, to enable Receiver to surrender the wooden cases and bottles to Wil-Rud Corporation, free and clear of any claims; that it would be cheaper for the Receiver to complete the proposed compromise than attempt to deliver approximately 25,000 cases free and clear of all claims, pursuant to the representations contained on page 88-a of the inventory described in Paragraph II of the Petition for Leave to Compromise. Referee found that it was not for the best interests of the estate to approve the proposed sale of the accounts receivable and therefore did not include the same as a part of the approved compromise and settlement.

The Referee then made the following Conclusions of Law: That it would be for the best interests of the estate to approve the compromise and settlement submitted in the petition, excepting therefrom the sale of the accounts receivable, and that the objections to the proposed compromise and settlement were not well taken.

Based upon the foregoing, the Referee made the following Order: That the petition of E. A. Lynch, as Receiver, to compromise and settle the claims involved in the sale to the Wil-Rud Corporation be, and the same was approved. That Wil-Rud Corporation was ordered to pay the Receiver the balance of $17,500.00 upon the purchase price, and Wil-Rud was ordered to hold the Receiver, and the said estate, harmless from any claims for refunds on cases up to 60 cents per wooden case. [R. 20-24.]

6. Petition for Review of Referee's Order.

Thereafter, and on March 8, 1948, Aaron Levinson, Bank of America, National Trust and Savings Association, Leo Brill, F. W. Boltz Corporation, a California corporation, and Victor Kramer filed with said Referee the aforesaid Petition for Review, alleging therein that each of the petitioners was a creditor of the said debtor, having aggregate claims in excess of $200,000.00. That the Receiver filed a Petition for Leave to Compromise the asserted claim by Wil-Rud and prayed that the same be approved and that they had appeared at the hearing of said petition. That on February 26, 1948, an Order was made by the Referee granting the petition, setting forth the substance of said Order. The petition then alleged that the said Order was erroneous as follows:

(a) That neither the Receiver nor Referee gave the creditors any information in the notice to them as to the nature of the claims, the amount of the claims, or the shortages claimed by the Wil-Rud Corporation.

(b) That nowhere in the proceedings, or in the notice to creditors, did it appear what the shortages were or on what Wil-Rud Corporation based its contentions that it was entitled to an adjustment on inventory shortages in the sum of $19,336.88.

(c) That the claims of Wil-Rud Corporation based on inventory shortages was without merit, since the Order confirming the sale transferred to Wil-Rud Corporation all right, title and interest of the estate, of all machinery, etc., located at 3631 Union Pacific Avenue, Los Angeles, California, together with other physical assets of the Debtor corporation "wherever situate . . . as of October 15, 1947, at 5:00 o'clock p. m."

(d) That the claim of Wil-Rud that Debtor's customers who had deposited 60 cents with Debtor had a lien on each wooden case was without merit.

(e) That the claimed lien was conjectural.

(f) That the record did not show how the Receiver arrived at the amount of $18,500.00 allowed the purchaser.

(g) That there was no substantial evidence introduced upon which the merits or demerits of the Petition for Leave to Compromise could be determined.

(h) That the merits of the claims of Wil-Rud Corporation first should have been determined before approval of the compromise.

(i) That no substantial evidence was offered to show that the proposed compromise was for the best interest of the creditors. [R. 25-28.]

7. Referee's Certificate on Review.

The Referee prepared and presented to the District Judge his Certificate on Review, stating in substance that E. A. Lynch was the duly appointed, qualified and acting Receiver in the within Chapter XI reorganization proceedings, and pursuant to Order of Appointment he took possession and continued operation of the business previously conducted by Debtor, consisting primarily of bottling of root beer and the sale of the root beer extracts. That

the major portion of the physical assets involved were located at the main bottling plant, 3631 Union Pacific Avenue, Los Angeles, California, and that in the administration of the estate, it became advisable for the Receiver to attempt to sell the assets of said estate. That after due notice to creditors, hearings were held before the Court on September 15, October 7, and October 15, 1947. That on October 15, 1947, Aaron Levinson, on behalf of C. Ray Miller, read to the Court an offer of $135,000.00 for the assets of the Debtor corporation, and had requested the Court to accept that offer, and not to permit competitive bidding for the assets. That said attorney purported to submit the offer and the request that it be approved, on behalf of the members of the Committee of Creditors, which included Aaron Levinson, Bank of America, National Trust and Savings Association, and F. W. Boltz Corporation, three of the creditors petitioning for review. Referee then stated that he opened the matter for competitive bidding and that Wil-Rud Corporation made the highest and best bid, offering $161,000.00 cash for the assets. That on October 22, 1947, said Referee signed an Order confirming the sale, and possession of said assets was given to Wil-Rud. That thereafter a dispute developed between the Receiver and purchaser, and pursuant to a verified petition, an Order to Show Cause was issued directing the purchaser to appear before the Referee on November 7, 1947, to show cause why the balance of the purchase price should not be paid. At said time the Wil-Rud Corporation had paid $100,000.00 toward the purchase price; that the Committee of Creditors had been informed of the Order to Show Cause, and some of them were present at the hearing. That from the evidence presented it appeared to the Referee that Wil-Rud Corporation had submitted its bid in reliance upon the inventory

admittedly shown by Receiver's representative to Samuel C. Rudolph, purchaser's representative. That at the hearing on November 7, 1947, Exhibit 1 was introduced, reflecting the claimed inventory shortages totalling a gross amount of $18,952.16. That Exhibit 2 introduced at said hearing was the inventory which was relied upon by the purchaser in making its bid. That at this hearing the Referee had indicated that he would rule that the purchase was made pursuant to the inventory, and that a pro rata allowance would be made to the bidder. That on November 7, 1947, there also was brought to the Court's attention that the purchaser was contending for an adjustment involving wooden cases and bottles used by the Debtor in the sale and delivery of its root beer products. That thereafter a petition was filed by Receiver to compromise the claims of Wil-Rud Corporation centering upon two problems: First, the inventory shortages covered in the hearing held on November 7, 1947; and second, a contention by the purchaser that the items contained on page 88-a of the inventory could not be delivered free and clear to the purchaser in that retail distributors had possession of the wooden cases and bottles involved and had paid 60 cents per case as a deposit thereon, and therefore had a lien for the amount of 60 cents per case predicated on their possession of the cases. That the gross amount in value of the cases and bottles involved was $47,976.29, and if this figure were recognized, then 40 per cent thereof would be the pro-rated deduction allowable to the purchaser. On the other hand, 25,807 wooden cases were involved, and if the estate were required to pay 60 cents per case to clear any claim of lien against the cases, the total involved would be $15,484.20. That after due written notice to creditors and interested parties, a hearing was had upon the petition of the Receiver to

compromise, including the aforesaid claims of Wil-Rud Corporation, and all other claims which Wil-Rud might have on the basis that an $18,500.00 reduction would be allowed on the total purchase price, making the net amount payable to the estate $142,500.00, and after allowing all payments previously made, the balance remaining would then be $17,500.00, and in addition thereto Wil-Rud Corporation agreed to hold the Receiver harmless of any claims or refunds arising from any attempts to return the cases by the distributors. That the hearing on said petition was had on January 29, 1948. That included at said hearing was a petition to sell outstanding accounts receivable, but after a consideration of the facts involved, the Referee denied the petition to sell and directed the Receiver to make his own collections. That on January 29, 1948, the Referee took the testimony of certain witnesses, to-wit, Ralph J. Yates, the accountant employed by Receiver and the testimony of Wolf Wilder and Samuel C. Rudolph, as agents of the purchaser, Wil-Rud Corporation. That after considering the facts, the arguments of counsel, and the objections of various creditors, the Referee determined that it would be for the best interests of the estate to approve the petition to compromise. The Referee further stated that he was convinced that the purchaser had relied upon the written inventory handed to its agents in preparation for bidding upon the assets. That the Referee further was convinced that the physical assets were sold free and clear to the purchaser, and that there was a strong possibility that the Receiver could not deliver clear title to the wooden cases and bottles involved without compensating the distributors to the extent of 60 cents per wooden case, since the distributors had possession of the cases and appeared to have a claim of lien thereon until the 60 cents deposit was returned, and that in addi-

tion thereto there was involved the practical problem of quieting title to thousands of wooden cases located in the hands of thousands of vendees. That under all circumstances, considering the legal and equitable problems involved, and the possibility of adverse rulings against the Receiver in the event of contested litigation and the expense of such litigation, the Referee ordered the proposed compromise with the Wil-Rud Corporation approved, and made Findings of Fact, Conclusions of Law and an Order thereon dated February 26, 1948. The Referee also stated that no order was sought, or obtained by the petitioners for review authorizing the filing of said petition, although they were not parties to the petition to compromise the differences between the Receiver and the Wil-Rud Corporation. The Referee recited that he had proceeded in pursuance to Section 27 of the Bankruptcy Act, U. S. C. A., Title 11, Chapter 4, Section 50, governing compromises. The Referee attached to the certificate the following documents: The Reporter's Transcript of Proceeding held on October 15, 1947; the Order Confirming Sale, dated October 22, 1947; Petition of Receiver for an Order to Show Cause directed against Wil-Rud; Order to Show Cause against Wil-Rud Corporation, issued October 31, 1947; Reporter's Transcript of the hearing held on November 7, 1947; Petitioner's Exhibit No. 1, containing itemization of inventory shortages; Petitioner's Exhibit No. 2, being the written inventory of the assets; Petition of Receiver, dated January 6, 1948, for Leave to Compromise; Notice of Hearing on Petition for Leave to Compromise, dated January 14, 1948; Reporter's Transcript of hearing held on January 19, 1948; Findings of Facts and Conclusions of Law and Order, approving Petition for Leave to Compromise; Petition dated March 4, 1948, for Review of the Referee's Order. [R. 29-36.]

8. Findings of Fact, Conclusions of Law, and Order Granting Petition for Review and Reversing Order of Referee.

On December 16, 1948, the District Judge filed a Memorandum Opinion granting the Petition for Review and Reversing the Referee's Order. [R. 37-43.] On May 24, 1949, he made and filed written Findings of Fact, Conclusions of Law, and the Order Granting the Petition for Review and Reversing the Order of Referee Approving Compromise. This Order was duly docketed and entered on May 26, 1949. The District Judge found the following: That E. A. Lynch was the duly qualified and acting Receiver and had conducted the going business of the bankrupt from his appointment on July 29, 1947, to October 15, 1947. That on October 15, 1947, he brought on for sale in open Court before the Referee certain assets of the Debtor, at which time there was competitive bidding. That a bid of $160,000.00 was offered and thereupon a bid of $161,000.00 was made on the same terms by the Wil-Rud Corporation for "all of the outstanding shares of Yankee Doodle Root Beer Company and for the physical assets of California Associated Products." That said bid and offer was accepted by the Court and Receiver, and the sale was confirmed by Order of Referee, and that Wil-Rud Corporation paid $125,000.00 on the purchase price of $161,000.00; that the business and assets had been in the possession of the Receiver for a period of time and the Receiver had been carrying on the business of the bankrupt corporation. That his inventory of assets made at the inception of the proceedings was not corrected or adjusted from day to day, and did not purport to be other than an inventory of July 28, 1947, which fact was made known to all bidders. That the assets were offered "as is" without warranty as

to quality or quantity and without reference to inventory. That immediately after the confirmation of the sale, the assets sold were delivered to Wil-Rud Corporation. That the Referee's Order approving and confirming the sale was approved in writing by Wil-Rud Corporation and signed by the Referee on October 22, 1947. That thereafter a controversy arose between the purchaser and Receiver, as set forth in Paragraph II, subdivisions (a) and (b), of the Receiver's Petition for Leave to Compromise, and thereafter the Receiver petitioned for authority to compromise the controversy. That ten days' notice was given to all creditors and upon the hearing the petitioners on review objected to the compromise, and that the record failed to disclose any creditors in favor of the compromise. That the sale was not one based upon the assets as reflected by the Receiver's inventory, nor was the bid of Wil-Rud so made, and that Wil-Rud was not warranted in relying, and that it did not rely upon the inventory in making its bid. That it was not for the best interests of the creditors that the proposed compromise be ordered. That no review was taken at any time by Wil-Rud from the Order of confirmation of sale, and that the same became final and that Wil-Rud took no steps to set aside said sale or return the property delivered to it by Receiver.

That the District Judge then made the following *Conclusions of Law:* That the Order of October 22, 1947, confirming the sale to Wil-Rud for $161,000.00 was final; that no review was taken therefrom. That the said proceedings for compromise could not be maintained as a collateral attack upon the said Referee's Order confirming sale. That the equities were not with the purchaser in that there was a $160,000.00 bid which was rejected because Wil-Rud increased the bid by $1,000.00, and that the said bid of $160,000.00 was for the assets as then

existing and not with the qualifications or restrictions insisted upon by Wil-Rud. That the creditors of the bankrupt would suffer a $18,500.00 loss if the Order of compromise were approved. That Wil-Rud did not disaffirm the sale but took possession of the assets and could not by a compromise attack the sale, and that Wil-Rud was bound by the rule of *caviat emptor*. That there was no evidence that anybody ever claimed a lien against the property purchased by Wil-Rud, other than the conditional sales contract specifically mentioned.

Based upon the foregoing, the District Judge made an order reversing the Referee's Order, dated February 26, 1948, approving the Receiver's compromise, and denied the petition to compromise. [R. 48.]

B. Statement of Facts.

On July 27, 1947, California Associated Products Co., a corporation, doing business as Yankee Doodle Root Beer Bottling Company, filed a Petition for Plan of Arrangement under Chapter XI of the Bankruptcy Act in the Court below in that certain proceeding entitled, "In the Matter of California Associated Products Co., a corporation, doing business as Yankee Doodle Root Beer Company, Debtor," No. 45137-BH, seeking thereby an arrangement with its creditors. Thereupon an approval and Order of reference was made by the Court and the matter was referred for all purposes to Referee Hugh L. Dickson. [R. 179.] Also, on July 27, 1947, E. A. Lynch was appointed Receiver, and after qualifying, took possession of Debtor's property, and continued the operation of the Debtor's business [R. 29; 45], consisting primarily of bottling of root beer and the sale of root beer extracts. Most of the physical assets involved were

located at the main bottling plant at 3631 Union Pacific Avenue, Los Angeles, California. [R. 29.] Thereafter Debtor failed to submit a satisfactory plan of arrangement [R. 1] and it became advisable for the Receiver to sell the assets of the estate. After due notice to creditors, hearings were held before the Referee on September 25, October 7 and October 15, 1947. [R. 29.] On October 15, 1947, various creditors, including certain of appellees, attended, and Aaron Levinson read to the Court a written offer of $135,000.00 made by one C. Ray Miller "for all of the outstanding shares of Yankee Doodle Root Beer Company" and "for the physical assets of California Associated Products" and for all trade names, trade marks, all formulas, and registered trade names and lessee's interest in the lease, excluding from said assets merchandise held by the Bank of America as security, cash on hand, accounts and notes receivable and deposits. The insurance was to be taken over on a pro rata basis, and title to the property was to be delivered free and clear, except as to the water softener. [R. 51-53.] Mr. Levinson advised the Referee that it was the unanimous opinion of the creditors representing over $200,000.00 in amount of claims (constituting the so-called "Committee of Creditors") that the said offer should be accepted, and that the Receiver should be directed to sell to said bidder without further competitive bidding. [R. 29-30; 53-54.] This the Referee refused to do. The matter was opened for competitive bidding [R. 30; 55], and the assets were sold to Wil-Rud Corporation for $161,000.00 [R. 68; 30] free and clear of all liens, charges, and incumbrances, excepting the said water softener.

On October 22, 1947, the Referee signed and filed his Order, which, among other things, approved and confirmed the sale of certain personal property to Wil-Rud Corpo-

ration for $161,000.00 cash, and further provided that "delivery of the assets to be made upon signing of the within order, and payment therefor to be made concurrently with delivery to the buyer." Said Order also stated that the Receiver "does sell to the buyer all machinery, fixtures, equipment, *all inventory,* all lessee's improvements, all furnishings, all supplies, and all finished and unfinished products of every class and character and description whatsoever . . ., together with all the other physical assets of the Debtor corporation, *wheresoever situated,* and together with all of the physical assets of every class and character of the Yankee Doodle Root Beer Company, a corporation . . .; all of said items are *sold free and clear* of any liens, charges and incumbrances . . ." It thus became the obligation of the Receiver under said Order to deliver to Wil-Rud Corporation *all inventory,* together with all of the other physical assets of the Debtor corporation, *wheresoever situated,* and that *concurrently, and only concurrently with said delivery,* the Receiver was entitled to be paid the sum of $161,000.00. Wil-Rud's obligation to pay, by the terms of said Order, was conditioned upon delivery to it of the described assets.

Such delivery was not made. After a checking of the delivered items by both Receiver and Wil-Rud, it was discovered that certain items set forth in the Receiver's inventory were not delivered to, or received by Wil-Rud, who thereby asserted that it was entitled to a credit upon the purchase price for the missing items. [R. 84-87.] On the other hand the Receiver demanded the balance of the purchase price, and on October 31, 1947, filed a Petition for an Order to Show Cause, to obtain the balance of the purchase price. [R. 8-9.] An Order to Show Cause was issued thereon and Wil-Rud Corporation was

ordered to appear before the Referee on November 7, 1947, to show cause why it should not pay the sum of $61,000.00, being the unpaid balance of the purchase price. [R. 10-11; 30.] The "Committee of Creditors" were informed of the Order to Show Cause, and several of them, including some of the appellees, appeared at, and participated in the hearing. At this hearing Ralph J. Yates, Receiver's representative, testified as follows:

> "Q. Before Mr. Rudolph purchased or made any bid in this case, do you know whether the inventory of July 28, 1947 was handed to him? A. Yes, it was.
>
> Q. You handed it to Mr. Rudolph? A. I did.
>
> Q. Do you remember the date that you handed it to Mr. Rudolph? A. About ten days before the first bidding. . . ." [R. 86-87.]

> "Q. Have you handed this inventory to any of the other bidders? A. I had.
>
> Q. And the instrument which I show you is a copy of the inventory which you handed to Mr. Rudolph some time before he started making the bids, is that right? A. It is the same one I handed to him.
>
> Mr. Katz: I would like to have this marked as an exhibit, the inventory.[6]
>
> The Referee: All right." [R. 87.]

On cross-examination Mr. Yates stated:

> "A. I told Mr. Rudolph that we had not taken a physical inventory, that Mr. Lynch had been operating the business and the Debtor had been operating the business since July 28, *and naturally there*

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[6]This is Petitioner's Exhibit 2, and by Order of this Court need not be reproduced in the printed transcript of record but will be considered by the Court in its original form. [R. 185.]

would be adjustments on the merchandise that had been used in connection with the operation of the business. I don't recall at this time any specific items that I mentioned." [R. 89.] (Italics ours.)

Mr. Yates further testified that shortly after the sale, he met with Mr. Rudolph to arrange for a check of the merchandise by representatives of both Receiver and purchaser, and that thereafter he checked the findings of both representatives. A physical count of the goods turned over to Wil-Rud was made against the original inventory, and a list of shortages was made by both the representatives. [R. 85-89.] Such shortages were specified in a document entitled, "Inventory Shortages at California Associated Products, Inc.," being Petitioner's Exhibit 1. [R. 81-83.] In this respect Mr. Yates testified:

"Q. This column that you prepared entitled 'Shortages,' that is actually a difference in the items that were reflected on the inventory and the items that were offered or delivered to the Wil-Rud Corporation, is that it? A. That is correct. It ties in with the physical check of the representative of the Receiver and the representative of the purchaser.

Q. Added to those items are some additional mistakes that somebody made who prepared the original copy of July 28, is that correct? A. That is correct." [R. 89.]

This document showed the actual differences in the items reflected in the original inventory which was shown to Mr. Rudolph before the sale and the items which actually were delivered to Wil-Rud [R. 89], and disclosed that the actual shortages of merchandise amounted to $15,488.99, and, by reason of errors in addition, there were additional shortages amounting to $3,466.17, making a grand total of $18,952.16 in shortages.

Mr. Rudolph testified as follows:

"Q. Mr. Rudolph, you are connected with the Wil-Rud Corporation, the purchaser in this proceeding? A. I am.

Q. About ten days before you made any bid in this proceeding did you go down to the place of business of the California Associated Products Company? A. I did.

Q. At that time were you handed an inventory by the representative of the Receiver? A. That is right.

Q. Were you able simply by going through the plant, for instance, to determine whether the quantity of concentrates on hand in the premises was actually the same amount which was shown on your inventory? A. There was no way to tell at all. They handed me the inventory and told me that was there and the only thing that was sold out of the inventory was some Monterey grape juice, or something, to a party by the name of Briggs. That was the only thing that they told me was sold.

Q. In your claim for shortages, did you make any claim for any item like that Briggs Monterey situation? A. No, sir, I did not.

Q. All you were told was sold was this one item? A. That is correct, sir.

Q. By simply looking at the plant were you able to determine whether there were eight thousand gallons of grape concentrate as distinguished from five thousand gallons? A. I think Mr. Yates did mention that there was 8000 because when I checked this inventory he told me, 'Sam, I think one mistake is on that eight thousand that was supposed to be there when we took this stock over.' We took for granted an inventory taken by the Receiver or Trustee is always correct and we have bought goods for the last

twenty-five or thirty years and we don't do a lot of checking when we go in and look at an inventory because we know when they check an inventory it is correct. They do make allowances when they are short or over. The reason we didn't pay the balance of the $161,000, we wanted to check and see if they were going to make good. We checked it once and they were dissatisfied and we had another man go over and make the second check.

Q. Who checked the second time? A. It was checked by the Receiver's man twice. They thought there was something wrong and they rechecked it again. Not only that, but they pointed out it was short and they would make it good.

Q. Who said that? A. Mr. Yates." [R. 98-100.]

It was stipulated that the shortages were as stated upon Petitioner's Exhibit 1. [R. 80, 110.] After argument by counsel, the Referee stated:

"The Referee: I am very much inclined to agree with you. I think a man ought to get what he buys, should get what he bids for. If he doesn't get it, he should not pay for it. You may prepare an order, Mr. Katz, to that effect." [R. 112.]

The problem of the wooden cases was then brought to the Referee's attention and the following proceedings were had:

"Mr. Katz: There remains the problem, Mr. Gendel, which you and I should work out on the assets being turned over to us. I am talking about the bottles we never received. Do you want to discuss that?

Mr. Gendel: I think it should be discussed because we are apparently going to have some litigation on the matter.

Mr. Katz: I think we can reach a stipulation on the facts without taking the Court's time and then submit the question to the Court. Would you like to do that? I think Mr. Lynch and Mr. Rudolph can reach an agreement on what the facts are.

Mr. Gendel: I don't even know what the problem is. If we can stipulate to save the Court time and properly present the facts, we will be glad to do it.

The Referee: Yes, let's do that.

Mr. Katz: I will prepare an order on this phase of it. On the other phase, let's put it over, say, about a week and see if we can get together.

Mr. Gendel: I don't know what it is about. There is nothing on the calendar.

Mr. Katz: Your order simply is to compel us to pay.

Mr. Gendel: That is right.

Mr. Katz: You say you have tendered the assets to us. Well, we want to pay you, but the order says we are to get the assets wheresoever situated.

Mr. Gendel: That is as of October 15.

Mr. Katz: Now, what happened was this. The Debtor had delivered various cases containing bottles, empty bottles or filled bottles of root beer. The customers and the storekeepers who had those cases had paid the Debtor, I think, sixty cents a case. We are entitled to those cases and we would like to get those cases from the customers.

Mr. Gendel: Are they shown as shortages on Exhibit 1?

Mr. Katz: They aren't short. They are in the possession of third parties.

The Referee: You gentlemen get together on a stipulation of facts, if you can.

Mr. Katz: All right. Otherwise, we will bring on a separate proceeding." [R. 112-113.]

The parties thereafter commenced negotiations to adjust the various differences, and finally a proposed compromise was reached. On January 6, 1948, a verified Petition for Leave to Compromise *re* Wil-Rud Sale was filed by Receiver, setting forth the various disputes, and the nature of the proposed compromise [R. 12-16], the substance of which has previously been stated. Due notice to creditors was given [R. 16], and a hearing before the Referee was had upon said petition. The situation, and the various problems with which the Receiver was confronted concerning the question of inventory shortages, was presented, and the fact that the Referee had indicated at the previous hearing that he would decide those issues in favor of Wil-Rud. The question of the wooden cases and bottles in the hands of customers of the Debtor was also presented. The Referee was told that the parties had arrived at a compromise, which, among other things, allowed Wil-Rud a credit of $18,500.00 on the purchase price. Evidence was then offered by the Receiver upon the petition. Mr. Yates, the Receiver's representative, testified that he had made an investigation of the books and records of the bankrupt, and that generally he had assisted the creditors, the Receiver, and the Court. He further testified as follows:

> "Q. With reference to the wooden cases and the twenty-four bottles in each of the wooden cases, what did you find when you investigated the books and records? A. May I refer to the inventory, please? This inventory was taken as of July 28. On page 88-A there appears an item representing 25,807 wooden cases and bottles. In addition to that, there were 74,640 root beer bottles, 634,708 root beer bottles. This item was set forth as alleged to be in the vicinity or territory of Los Angeles, California.

That item was estimated by the deposits that were totaled from the cards that they had out there representing cases outstanding in the territory on which there was a deposit of sixty cents a case.

Apparently no issue is being made of the 74,000 and the 634,000 root beer bottles. Mr. Katz overlooked that, apparently. But on the 26,000 wood shells and bottles, there is a liability of sixty cents on those which would run over $16,000. On the basis of forty cents on the shortage there would be an adjustment of $18,000 coming to Mr. Katz; and on the 20,000 shortage that has been ruled on before there would be another $8000, or $28,500. I understand he is willing to compromise for $18,500 and we are making $10,000 on that matter . . ." [R. 124-125.]

"Q. (By Mr. Gendel): My question was directed for the moment as to how you ascertained to your own satisfaction that sixty cents per shell, as you described it, for over 25,000 shells had actually been paid over to the California Associated Products Company prior to the commencement of the debtor proceedings by the various people who had possession of the cases or shells . . ." [R. 125.] . . .

"The Witness: Here is how I ascertained it. Mr. Brill, the agent and representative of the Creditors Committee, went through the list with the inventory men, and with Mr. Tanner, and tied in with the deposit control that Mr. Tanner had, and in conjunction with these cards that they had in the offices, and on that basis they estimated the outstanding cases and shells.

Q. (By Mr. Gendel): Did you yourself see these cards? A. Yes, I saw the cards.

Q. Were there any notations on the cards reflecting the receipt of sixty cents per shell? A. Yes.

Q. Where are those cards now? A. They are in the office.

Q. Was there any separate books other than regular books of entry of the corporation which indicated the receipt of the moneys? A. Not identifying these particular customers that they had a general control which as it set forth here alleged and estimated and would be very difficult for any one to reconcile.

Q. By checking the regular books and records you could not tell where the money came from or that it was to be applied on these so-called deposits, is that right? A. No . . ." [R. 126.] . . .

"Q. Is there anything in the inventory which reflects that these shells are subject to sixty cents per case? A. No, there isn't.

Q. You have examined the whole inventory, have you? A. That is correct.

Q. That obligation is not set forth there at all, is it? A. That is correct." [R. 127.]

On cross-examination by appellees, Mr. Yates stated he did not personally know the exact number of cases in the hands of distributors but that the figures given had been obtained from the records, and that in arriving at the number of cases in the hands of distributors, he took only 50 per cent of the number shown on the records. [R. 128; 141, 142.] He stated that no distributors had contacted him personally for the return of the 60 cents, but that when cases had been returned, the distributors had been credited with 60 cents per case [R. 129]; that customers had put up the deposit when the cases were delivered and had paid the 60 cents to the bankrupt's drivers. [R. 133.] He stated that he was familiar with the practice, regarding the deposits on cases, used by Debtor,

which practice the Receiver followed; that when cases of root beer were delivered to the customer, 80 cents would be charged for the product and a 60 cent deposit charged for the cases; that a credit of 60 cents per case would be given on returned cases and that the difference between the total charges and the credits on returns would be paid in cash to the driver. [R. 142.] Whenever the customer returned a case, he became entitled to a refund of the 60 cent deposit; that during the time the Receiver operated Debtor's business, the drivers were instructed to give each customer 60 cents, either in credit or cash, for each returned case [R. 143], thus continuing the previous practice of the Debtor. That the Receiver could not pick up a case from a customer *unless the driver gave him the sixty cents.* [R. 143.] That the actual worth of the cases and empty bottles was approximately $1.80, and therefore it was more advantageous to refund the 60 cents than to permit the case and bottles to remain with the customers [R. 143]; and that stamped upon each case was a legend concerning the 60 cent deposit. [R. 146.]

Wolf Wilder, also a witness for the Receiver and connected with Wil-Rud, testified that upon each delivery slip or invoice given to customers there was the name of Yankee Doodle Root Beer Company, the customer's name, the words "fulls, medium or small," and "empties, large, medium, small," and a notation, "Charge customer for amount of fulls less the amount of empties returned," and the "net amount to be paid in cash is to be charged." [R. 155.] That upon each wooden case there was stamped a round circle with the word "deposit" half way around it, and "60¢" burned in the wood. [R. 156.]

Sam Rudolph also was called as a witness by the Receiver and testified that he had examined page 88-A of

the inventory containing an item consisting of bottles and cases, and that this item had never been delivered to Wil-Rud by the Receiver. [R. 169.] Page 88-A of the inventory reads as follows:

> "Alleged to be in the vicinity or territory of Los Angeles, California.
> 74,640 root beer bottles 7 oz. 518.13 Gross 5.80 .....$ 3,006.33
> 634,708 root beer bottles 10 oz. Gross 6.11.. 26,930.87
> 25,807 wood shells (hold 24 each) each .699 ..... 18,039.09
> Above figures received from Mr. Leo Brill on August 13, 1947." [R. 170.]

(Mr. Brill therein referred to is an appellee herein.)

During the course of this hearing the Referee stated:

> "I wish you would bear in mind, gentlemen, that I am not going to let anybody buy something in this court and then pay for something he doesn't get.
>
> Mr. Levinson: I quite agree with Your Honor in that regard. No one should have to pay for anything they don't get. * * *." [R. 133.]

The Referee, after due consideration of the evidence and objection to the compromise, stated:

> "I think this compromise is fair. I don't think any man ought to be required to pay for anything he doesn't get. He had a right to rely upon the inventory prepared. So I will approve this compromise." [R. 167.]

The objecting creditors (appellees) offered no evidence at said hearing. On February 26, 1948, the Referee filed Findings of Fact and Conclusions of Law and Order Approving Compromise.[7] [R. 24.] On March 8, 1948, cer-

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[7]These Findings and Order are summarized, pp. 11 and 12 of this brief.

tain creditors (appellees) filed the Petition for Review.[8] [R. 25-28.] Thereafter, the Referee filed his Certificate on Review[9] [R. 29-36], wherein, among other things, he stated the following: That creditors petitioning for review had requested the Court to accept a bid of $135,000.00 for the assets on behalf of one Miller (previously approved by Creditor's Committee), and not to permit competitive bidding [R. 29-30]; that the Referee opened the matter for competitive bidding and Wil-Rud purchased the assets for $161,000. That at a hearing on November 7, 1947, it appeared from the evidence that Wil-Rud had submitted its bid in reliance upon an inventory admittedly shown by Receiver's agent to Wil-Rud's representative before the sale [R. 31]; that the inventory shortages amounted to $18,952.16, and the Referee indicated he would rule that the purchase was made pursuant to the inventory, and would make a pro-rata allowance. At said hearing it was brought to the Referee's attention that certain wooden cases could not be delivered to Wil-Rud free and clear. [R. 31.] That at the hearing on the petition for compromise evidence was received, and the Referee was convinced that Wil-Rud had relied upon the inventory handed it in preparation for bidding upon the assets [R. 33]; that the assets had been sold free and clear, and that there was a strong possibility that Receiver could not deliver clear title to the wooden cases without refunding 60 cents per case to distributors who had a lien for said sum by virtue of possession. That under all circumstances, considering the legal, equitable and practical problems, the possibility of adverse ruling, the ex-

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[8]This Petition is summarized, pp. 13 and 14 of this brief.

[9]This Certificate on Review is summarized, pp. 14 to 18 of this brief.

penses of litigation, the proposed compromise should be accepted, and was ordered. [R. 34.] On December 16, 1948, the District Judge rendered a Memorandum Opinion [R. 37], and on May 26, 1949, filed Findings of Fact, Conclusions of Law, and Order reversing the Referee's Order and rejecting the compromise. [R. 44-48.][9a]

C. Questions Involved.

1. Did the District Court err in granting the Petition for Review and reversing the Referee's Order Approving Compromise?

2. Did the record on Review disclose a clear abuse of discretion by the Referee in approving the compromise so as to justify the District Court in granting the Petition for Review and reversing the Referee's Order?

3. Did the District Court, upon a Petition for Review from the Referee's order approving a compromise, err in determining the issues involved in the *merits* of the controversy between Receiver and appellant, thereby depriving appellant of its day in Court, upon the merits of the controversy?

4. Did the District Court, upon the Petition for Review, err in trying the factual questions *de novo,* and in rejecting the Referee's findings, and the Referee's determinations as to the credibility of witnesses and the weight be accorded to the evidence?

5. Is the Order of the District Court reversing the Referee's Order supported by the evidence?

6. Is the Order of the District Court reversing the Referee's Order contrary to the evidence.

7. Are the material Findings of Fact of the District Court supported by the evidence?

[9a]These Findings are summarized, pp. 19 to 21 of this brief.

8. Are the material Findings of Fact of the District Court contrary to the evidence?

9. Did the District Court err in applying the doctrine of *"caveat emptor"* to appellant where the Order of Confirmation of Sale expressly provides that the property sold included, among other things, "all inventory" and "all other physical assets of Debtor corporation wheresoever situated," and that "all of said items are sold free and clear of any liens, charges and incumbrances"?

10. Was the District Court entitled to apply, and did it err in applying the *"caveat emptor"* doctrine, as aforesaid, upon the Petition for Review involved herein?

11. Did the District Court err in holding that there were no liens or charges against the various wooden cases where the undisputed evidence shows the customer had made a 60 cent deposit with the Debtor for each wooden case and bottles, and were entitled to retain possession of such cases until the 60 cent deposit per case was refunded, either in cash or by a credit?

12. Was the District Court entitled to hold, and did it err in holding that there were no liens or charges upon the wooden cases in the possession of customers, as aforesaid, upon the Petition for Review involved herein?

13. Did the District Court err in holding that appellant's efforts to show that the Receiver did not comply with the terms of the Order of Confirmation of Sale by failing to deliver all inventory items purchased, and by failing to deliver certain property "free and clear," constituted a collateral attack upon such Order?

14. Was the District Court entitled to make, and did it err in making such a determination regarding "collateral attack," as aforesaid, on the Petition for Review involved herein?

Specification of Errors.

1. The District Court erred in granting the Petition for Review, and in reversing the Referee's Order Approving Compromise between Receiver and appellant and in denying said petition.

2. The District Court erred in determining on the merits the issues involved in the controversy between the appellant and Receiver upon the Petition for Review from the Referee's Order approving the compromise, as those issues were not before the Court for determination upon the Petition for Review, and its determination thereof deprived appellant of its day in Court on the issues involving the merits of the controversy.

The District Court, in granting the Petition for Review, reversed the Referee's Order and denied the compromise, and determined upon the merits the controversy between the Receiver and appellant, thereby depriving appellant of its day in Court on those issues. The District Court could not determine those issues upon the Petition for Review.

3. The District Court erred in trying on the Petition for Review the factual questions *de novo* and in rejecting the Referee's Findings, the Referee's determinations as to credibility of witnesses and the weight he accorded to the evidence.

The Findings of the District Court state [R. 45]:

> "The Court cannot adopt the Findings of the Referee in this matter and therefore finds: . . ."

and affirmatively show that the District Court rejected the Findings of the Referee and tried the factual questions involved *de novo*. In making its findings of the facts, the District Court disregarded and rejected the Referee's determination regarding the credibility of the various wit-

nesses, and the weight which he accorded the evidence. The District Court rejected all evidence, accepted and believed by the Referee, which without conflict showed that prior to the sale Receiver's agent had submitted to Wil-Rud's representative an inventory [R. 86, 99, 168], and told Wil-Rud's representative that an adjustment would have to be made as to items which had been used in the operation of the business [R. 89]; that Will-Rud made its bid in reliance upon the inventory; that it was warranted in relying upon it [R. 99-100, 31, 33, 107]; that there was a shortage of inventory items in the sum of $18,952.16 [R. 81, 83, 87, 89]; that the Referee, after a hearing, stated he would rule that the purchase was made in reliance upon the inventory shown to Wil-Rud's representative. [R. 31, 33, 107, 112.] The District Court also apparently disregarded evidence to the effect that it was the custom and practice of Debtor and Receiver, while operating the business, to charge a 60 cent deposit for each wooden case, and to refund the 60 cent deposit per case to the customer, either by a credit or in cash, and the Receiver's records so indicated [R. 124-130, 142-143]; that the Referee was convinced that the Receiver could not deliver the cases free and clear without refunding the 60 cent per case deposit to customers, who by virtue of possession held a lien upon said cases [R. 32, 34]; that considering the expenses and uncertainty of litigation, and the problems involved, it appeared to the Referee that the compromise was for the best interests of the creditors. [R. 34.] The District Court, in its Findings, also utterly disregarded the terms and provisions of the Order of Confirmation of Sale [R. 4], the Referee's construction of and weight given to the evidence; and Referee's determination that Wil-Rud's bid was made in reliance upon the inventory, and that it was justified in relying thereon.

[R. 31, 33, 100, 107, 112, 133.] The District Court on this Petition for Review could not revaluate and reweigh the evidence, or disregard testimony of witnesses given credence by the Referee, or give to the evidence an entire different weight than that given to it by the Referee, or draw inference or deductions therefrom contrary to those which the Referee had made.

4. The District Court erred in making the following portion of Finding No. 1, as follows:

> ". . . A bidder offered $160,000 and thereupon a bid of $161,000 was made on the same terms by the Wil-Rud Corporation 'for all of the outstanding shares of Yankee Doodle Root Beer Company and for the physical assets of California Associated Products . . .' . . ." [R. 45.]

in that said Finding is not supported by the evidence, and is contrary thereto, and finds upon an immaterial matter, as rights and obligations of appellant and Receiver are fixed by the Order Confirming Sale, and not by the bid.

The evidence shows that a bid of $160,000.00 was for "all of the outstanding shares of Yankee Doodle Root Beer Company" and "for the physical assets of California Associated Products" and for all trade names, trade marks, all formulas, and registered trade names, and lessee's interest in the lease, including all understandings which any officers of Debtor had with landlord regarding a renewal, or extension of the lease, and the insurance on a pro-rate basis. The only exclusions mentioned were merchandise held by the Bank of America as security, cash on hand, accounts and notes receivable, and deposits. Title to the property was to be delivered free and clear, except as to the water softener. [R. 51-53.] The Order of Confirmation of Sale provided that the Receiver sold to

Wil-Rud all machinery, fixtures, equipment, *all inventory,* all lessee's improvements, all furnishings, all supplies, all finished and unfinished products of every class, character and description, together with all other physical assets of the Debtor corporation, wheresoever situated, together with all of the physical assets of every kind and character of the Yankee Deedle Root Beer Company, a corporation; that all of said items were sold free and clear of any liens, charges, and incumbrances. [R. 4-5.] The evidence further shows that an inventory furnished by Receiver was presented to Wil-Rud's representative before the sale, that Wil-Rud made its bid in reliance thereon and was told that any shortages would be adjusted. (See evidence under succeeding Specification of Errors.) There never was any evidence offered, or statements made, that merchandise sold or used was to be excluded.

5. The District Court erred in making the following portion of Finding No. 2, reading as follows:

> ". . . That said inventory does not purport to be other than an inventory made as of July 28, 1947. That this fact was made known to all bidders. That at the time of the sale the said assets were offered 'as is' and without any warranty as to quantity or quality and without any reference to any inventory. That immediately after the confirmation of the sale, the assets so sold were delivered to the Wil-Rud Corporation. . . ." [R. 46.]

in that said Finding is unsupported by the evidence and is contrary thereto.

The sole and only evidence upon that issue is as follows: Ralph J. Yates, Receiver's representative, testified that shortly before the sale he had delivered an inventory of the assets to Samuel C. Rudolph, Wil-Rud's represen-

tative, and had given it to other bidders [R. 86-87]; that both the Debtor and Receiver had been operating the business and he told Rudolph "naturally there would be adjustments on the merchandise that had been used in connection with the operation of the business." No specific items were mentioned [R. 89]; that after the sale was confirmed, a physical check by Receiver's and Wil-Rud's representatives had been made of the merchandise delivered against the inventory, and the shortages had been indicated upon a statement [R. 81-83], which he checked. [R. 86.] Samuel C. Rudolph testified that about ten days before the sale he went to Debtor's place of business and was handed an inventory by Receiver's representative; that he was told that the only thing sold from the inventory was some Monterey Grape Juice; that no claim for shortages was made for that item. [R. 99.] That shortages could not be determined by an inspection of the plant; that for years he had purchased merchandise at Receiver's and Trustee's sales, and found that he could rely upon inventories given to him by Receivers or Trustees, and that shortages were always adjusted. [R. 100.] The undisputed evidence shows that some time after the sale, the goods delivered were checked by representatives of Wil-Rud and Receiver against the original inventory, and that the shortages were listed upon a document entitled, "Inventory Shortages at California Associated Products, Inc." [R. 81-83.] The Referee's Certificate states that Wil-Rud had submitted its bid in reliance upon the inventory admittedly shown its representative [R. 31]; that the purchaser had relied upon the written inventory in bidding upon the assets, which were sold free and clear to the purchaser. [R. 33-34.] The Order Confirming Sale states that the Receiver sold to Wil-Rud cer-

tain described property, including "all inventory," together with "all of the other physical assets of the Debtor corporation, wheresoever situated," and that "all of said items are sold free and clear of any liens, charges and incumbrances." [R. 5.] Even the original bid of $135,000 by Miller indicated that title was to be delivered "free and clear," except the water softener. [R. 53.] All property described in the Order Confirming Sale was never delivered to Will-Rud; the shortage, described on Petitioner's Exhibit 1 [R. 81-83], amounted to $18,952.16. Upon page 88-A of the inventory submitted to Wil-Rud's representative before the sale, there was an item representing 25,807 wooden cases. The inventory contained nothing indicating that this item was subject to a 60 cent deposit per case. [R. 127.] This deposit had to be refunded when the empty cases were returned, either in cash or by credit. [R. 133, 142, 143.] The Referee's Certificate on Review states that the wooden cases and bottles involved could not be delivered free and clear to purchaser because retail distributors had possession of the wooden cases and bottles involved, and had paid a 60 cent deposit per case; and therefore had a lien for said amount predicated upon possession of the cases. [R. 32.]

There is no evidence that the sale of assets was made "as is" and without any warranty as to quantity or quality, and without any reference to inventory. It is all to the contrary.

6. The District Court erred in making the following Finding of Fact, being Finding No. 4, reading as follows:

> "4. That said sale was not made on the basis of a sale of the assets as reflected in the receiver's inventory as of the close of business on July 28, 1947, nor was the bid of Wil-Rud so made." [R. 46-47.]

in that said Finding is not supported by the evidence and is contrary thereto.

The undisputed testimony shows that Yates, Receiver's representative, gave to Wil-Rud's agent a copy of the Receiver's inventory about ten days before the sale [R. 86-87], and stated that adjustments would have to be made on the items used. [R. 89.] Rudolph testified that he was given the inventory but could not, from an inspection of the plant, discover any shortages [R. 99]; that he was told the only shortage was some Monterey Grape Juice, for which no claim has been made. [R. 99.] That for years he had purchased at bankruptcy sales, and found he could always rely on inventories given him by Trustees or Receivers, and that shortages always were adjusted, and that he made his bid based upon the inventory submitted to him. [R. 100.] The Referee's Certificate states that Wil-Rud had submitted its bid in reliance on the inventory admittedly shown to its representative. [R. 31.] That this inventory was presented to the Court in evidence. [R. 31.] That after a hearing the Referee was convinced that Wil-Rud had relied upon the inventory in making its bid [R. 33]; that he would rule that the purchase was made pursuant to the inventory. [R. 31.] At this hearing the Referee stated to appellant, "They wouldn't give you a long document, or even make it up, if they didn't expect you to rely on it." [R. 107.] The Order Confirming Sale expressly includes "all inventory."

7. The District Court erred in making the following Finding, being Finding No. 5, reading as follows:

> "5. That the said Wil-Rud Corporation was not warranted in relying upon nor did it rely upon the inventory in making said bid. That it was not in the best interests of creditors that the said proposed compromise be ordered." [R. 47.]

in that said Finding is not supported by the evidence and is contrary thereto.

The undisputed evidence shows that Yates, Receiver's representative, testified that shortly before the sale he had delivered an inventory of assets to Rudolph, Wil-Rud's representative, and had given it to other bidders [R. 86-87]; that both Debtor and Receiver had been operating the business, and he told Rudolph "naturally there would be adjustments on the merchandise that had been used in connection with the operation of the business." No specific items were mentioned. [R. 89.] Rudolph testified that about ten days before the sale he went to Debtor's plant and was handed an inventory by Receiver's representative, and was told that only some grape juice had been sold [R. 99]; that an inspection of the premises could not disclose any shortages; that he relied upon the inventory in making the bid for Wil-Rud; that he found that from 35 years of purchasing at bankruptcy sales that he could always rely on the inventory of the Trustee or Receiver in making a bid, and that if there were any shortages, the same would be adjusted. [R. 100.] The Referee at the hearing on November 7, 1947, stated to Wil-Rud's attorney, "They wouldn't give you a great long document (inventory), or even make it up if they didn't expect you to rely on it" [R. 107], and in his Certificate on Review noted that Wil-Rud had submitted its bid in reliance upon the inventory shown its representative [R. 31]; that at a previous hearing he (Referee) had indicated that he would rule that the purchase had been made pursuant to the inventory, and that a pro-rata allowance for shortages would be made [R. 31]; that he (Referee) was convinced that the purchaser (Wil-Rud) had relied upon the written inventory handed to its agent in preparation for bidding on the assets. [R. 33.] The Referee further

stated that the property had been sold free and clear to the purchaser. [R. 34.] The Order Confirming Sale also included among the assets sold "all inventory" [R. 4], and stated the items were sold free and clear of any liens, charges and incumbrances. [R. 5.] The original Miller bid provided that the property be free and clear. [R. 53.] The evidence showed that the inventory did not indicate that the 25,807 wooden cases and bottles were subject to 60 cent deposits [R. 127]; that the distributors had been charged a deposit of 60 cents per case when they received the cases, and received a refund of 60 cents when the empties were returned [R. 142-143]; that the liability of the deposits upon the cases would run over $16,000.00. [R. 125.] The shortages were $18,952.16. [R. 81-83.] Before the Receiver could deliver the cases to Wil-Rud free and clear of all claims, liens and incumbrances, it appeared to be necessary for the Receiver to quiet title to the cases or to make the refunds. [R. 34, 23.]

The evidence shows that it was for the best interest of the creditors to compromise the claims of Wil-Rud. The inventory shortages amounted to $18,952.16 [R. 81-83]; the liability for the 60 cent deposit on the cases ran over $16,000.00; Wil-Rud logically could claim from the Receiver a sum in excess of $28,500.00. [R. 125.] Besides, Wil-Rud agreed to hold the Receiver harmless from refunds of the 60 cent deposits [R. 19, 22], and the Receiver avoided the cost, expenses, and necessity of legal proceedings to quiet title to thousands of cases in the hands of customers. [R. 34.] Under the compromise, the Receiver benefited by and saved over $10,000.00 from the amount Wil-Rud reasonably could claim, and the Receiver avoided litigation and expense with the customers holding the empty cases. The compromise reduced the purchase price to $142,500.00, more than $7,500.00 above

the bid of $135,000.00 originally submitted by Miller, and *approved by the Creditor's Committee, with a request that the Referee accept the same and direct the Receiver to sell the assets for said amount without competitive bidding.* [R. 51-54.] The objecting creditors offered no evidence whatsoever that the proposed compromise was not for the best interest of creditors.

8. The District Court erred in making Conclusion of Law No. 2, reading as follows:

> "2. That the within proceedings cannot be maintained as a collateral attack upon the Referee's order of sale dated October 22, 1947." [R. 47.]

in that the Petition for Leave to Compromise was not a collateral attack upon the Order Confirming Sale dated October 22, 1947, and that such conclusion is contrary to law, and contrary to and not supported by the evidence.

The District Court overlooked the *undisputed* evidence that Wil-Rud made its purchase in reliance upon an inventory admittedly shown to it by Receiver's agent; that there was a shortage of inventory items amounting to $18,952.16; that the property was sold free and clear of any liens, charges and incumbrances, and that certain wooden cases were not "free and clear." That the terms and provisions of the Order Confirming Sale which specifically described the property sold, including therein "all inventory" and "all other physical assets wheresoever located" and that said items were sold "free and clear of any liens, charges, and incumbrances," *and made payment concurrent with delivery* of the assets. The dispute arose out of the Receiver's failure *to comply* with the express terms of said Order Confirming Sale. It was for the Referee to determine whether the Receiver *had complied* with the Order Confirming Sale, and to do so was not a

collateral attack upon the order. If there was no compliance by Receiver, Wil-Rud then was entitled to an *abatement* in the purchase price.

9. The District Court erred in making Conclusion of Law No. 3, reading as follows:

> "3. That the equities herein are not with the purchaser in that there was a bid of $160,000 which was rejected because said Wil-Rud Corporation increased said bid by $1,000; that said bid of $160,000 was for the assets as they then existed and not with the qualifications or restrictions now insisted upon by said Wil-Rud Corporation. That the creditors of this bankrupt will suffer a loss of $18,500 if the order of compromise is finally approved." [R. 47-48.]

in that the same is contrary to law and is contrary to, and is not supported by the evidence.

Such conclusion overlooks the evidence disclosing that Wil-Rud's bid was made pursuant to and in reliance upon the Receiver's inventory admittedly given to Wil-Rud's agents prior to the sale [R. 86-87] with the statement that if there were missing items, the same would have to be adjusted. [R. 89.] At a hearing the Referee stated that he would rule in favor of Wil-Rud on the shortages [R. 112, 31]; and stated in his Certificate that Wil-Rud had relied upon the inventory in making its bid. [R. 31.] This was shown to Wil-Rud for the purpose of relying thereon. [R. 107.] The undisputed evidence shows $18,952.16 shortages [R. 81-83]; that over 25,000 wooden cases were subject to deposits of 60 cents per case in favor of customers who by virtue of possession had a lien to the extent of the deposits. [R. 32, 34, 133, 142, 143.] The Order Confirming Sale included "all inventory" and "all other physical assets wheresoever located" and that

all items were sold "free and clear of any liens, charges and incumbrances." It was for the Referee to determine the meaning of those terms, and whether there had been a compliance therewith. The evidence further showed that the Creditor's Committee, including appellee creditors, had recommended a bid of $135,000 and had requested the Referee to accept it, and direct Receiver to sell at said figure *without* competitive bidding. [R. 29, 30, 52, 53, 54.] The compromise was $7,500 in excess of *this* bid. Besides, under the compromise appellant was to hold the Receiver harmless from any claims of the 60 cent per case refunds. There is no evidence that the $160,000 bid was for the assets as they then existed. The bid made certain exclusions [R. 53] which did not include missing items or shortages.

10. The District Court erred in making Conclusion of Law No. 4, reading as follows:

> "4. That said Wil-Rud Corporation did not disaffirm the sale but took possession of the assets and cannot in this manner attack the sale; and said Wil-Rud Corporation is bound by the rule of *caveat emptor.*" [R. 48.]

in that the same is contrary to law, and contrary to and not supported by the evidence.

This conclusion of law overlooked the undisputed evidence that the property was purchased in reliance upon an inventory admittedly shown Wil-Rud's agent by Receiver's representative [R. 86-87]; and that adjustments would be made [R. 89]; that the Order Confirming Sale included in the property sold "all inventory" and "all other physical assets wherever situated," and that all items were sold "free and clear of any liens, charges and incumbrances," and made payment concurrent with delivery of

all assets. [R. 4-5.] Appellant claimed that Receiver had not delivered all property in accordance with and as provided by the terms of said Order. [R. 12.] The question was whether the Receiver had complied with the Order. The Order Confirming Sale contained *express warranties;* and by reason of the representations by Receiver's agent, the rule of *caveat emptor* was not applicable. After the Referee had interpreted the Order and had determined that Receiver had not complied therewith, Wil-Rud was entitled to a credit, the amount of which was a proper controversy to compromise. Under the circumstances the Referee was justified in ordering the compromise.

11. The District Court erred in making Conclusion of Law No. 5, reading as follows:

> "5. That there is no evidence that anyone has ever claimed a lien against the property purchased by said Wil-Rud Corporation from the receiver, other than the conditional sales contract holder specifically mentioned in the order confirming the sale to Wil-Rud Corporation." [R. 48.]

in that the said conclusion is contrary to law and contrary to, and not supported by the evidence.

This conclusion overlooks the undisputed evidence that a 60 cent deposit had been made by customers on each wooden case when they purchased the product, during the time Debtor and Receiver operated the business [R. 129, 133, 142]; that such customers were entitled to a refund of this deposit [R. 142-143]; *that an empty case could*

not be picked up from the customer unless the driver gave him 60 cents [R. 143]; that such was the practice of both Debtor and Receiver. [R. 143.] That no specific person made a *"claim of lien"* is immaterial and did not extinguish any lien or adverse claim against empty cases; they claimed the 60 cent deposit, and the empty case could not be taken from the customer "unless the driver paid him sixty cents." [R. 143.] A lien dependent upon possession existed and was not extinguished as long as the obligation to refund remained.

12. The District Court erred in making the following Order:

> "Therefore, for the reasons as set forth herein, the Order of the Referee dated February 26, 1948, affirming the Receiver's compromise whereby he credited to the Wil-Rud Corporation the amount of $18,500 upon its purchase price of $161,000 should be and the same hereby is reversed and set aside, and said petition to compromise denied." [R. 48.]

in that said Order is contrary to law, and is contrary to and not supported by the evidence.

Summary of Argument.

The headings on our argument have been prepared so that they may serve as a summary. Accordingly, we incorporate by reference the index of the argument appearing at the commencement of this brief as our summary of the argument.

ARGUMENT—POINTS AND AUTHORITIES.

I.

The District Court Erred in Reversing the Referee's Order Approving the Compromise as the Record Discloses No Abuse of Discretion Whatsoever by the Referee in Approving the Compromise.

Upon a Petition for Review from a Referee's order approving a compromise, the record *affirmatively* must show a *clear abuse of discretion* by the Referee before the order can be reversed by the District Judge. The record herein is totally *devoid* of any such showing.

Primarily it is appropriate to refer to certain fundamental principles of law controlling the issues involved.

(a) The basic statutory provision involved herein (U. S. C. A., Title 11, Sec. 50; Bankruptcy Act, Sec. 27) reads as follows:

> "The receiver or trustee may, with the approval of the court, compromise any controversy arising in the administration of the estate upon such terms as he may deem for the best interest of the estate."

(b) A controversy within the terms of that section is a disagreement or disputatious difference. (*In re Towers,* 27 Fed. Supp. 693.) It implies a dispute to be settled. (*Mueller v. Elba Oil Co.,* 21 Cal. 2d 188, 203, 130 P. 2d 961.)

(c) Jurisdiction to approve a compromise is conferred by the foregoing statute (11 U. S. C. A., Sec. 50), rather than by the General Orders. (*In re L. M. Axel Co.,* 3 F. 2d 581; *Petition of Stuart,* 272 Fed. 938.)

(d) A court of bankruptcy possesses not only the powers of a court of equity to settle controversies between the trustee or receiver and claimants, but has the express authority under the foregoing section to approve such settlement when for the best interest of the estate. (*In re Van Camp Prod.,* 95 F. 2d 206.)

(e) The term "court," as used in the foregoing section, includes the Referee of the court in which the bankruptcy proceedings are pending. (U. S. C. A., Title 11, Sec. 1(9); *Mueller v. Elba Oil Co.,* 21 Cal. 2d 188, 206, 214, 130 P. 2d 961.)

(f) The fairness of the Receiver's compromise of claim is a matter initially for the Receiver and finally for the Referee, the Referee's action being subject only to review for clear abuse of discretion. (*In re Paley,* 26 Fed. Supp. 952.) The fact that the Receiver favors the settlement is entitled to great weight. (*In re Paley, supra.*)

(g) Creditors are entitled to be heard, and to vote, but their action is merely advisory and it is not binding upon the court (*Hair v. Byars,* 92 F. 2d 684; *In re National Public Service Corp.,* 68 F. 2d 859); the final responsibility rests with the Referee to approve or disapprove the compromise. (*In re Paley, supra.*) Where only the objecting creditors are represented at the hearing, a vote is unnecessary. (*In re Paley, supra.*)

(h) The power to "compromise a controversy" is one of the broadest powers conferred by the Bankruptcy Act. Under that power almost anything desirable in the interests of the estate can be accomplished, *even though in ways that otherwise would be irregular.*

In *In re Stuart,* 272 Fed. 938, the Court states:

> ". . . The authority to compromise conferred by §27 of the Bankruptcy Act is in terms unlimited:
>
> 'The trustee may, with the approval of the court, compromise any controversy arising in the administration of the estate upon such terms as he may deem for the best interests of the estate.'
>
> The section clearly does not limit the right of compromise to controversies in which all creditors have the same interest."

In the *Matter of Anderson Thorson & Co.,* 125 F. 2d 325, the Court states:

> "This provision has been generally construed as lodging a broad discretion in the District Courts in the compromise of bankruptcy controversies, and reviewing courts have refused to interfere with such discretion except upon a clear showing of abuse."

(To same effect: *In re Niagara Falls Milling Co.,* 34 Fed. Supp. 801; *In Matter of Prudence Co., Inc.,* 98 F. 2d 559; *Scott v. Jones,* 118 F. 2d 30; *In re Riggi Bros. Co.,* 42 F. 2d 174; 2 Rem. on Bkcy. 720; *Mueller v. Elba Oil Co.,* 21 Cal. 2d 188, 130 P. 2d 961.)

(i) The order of the Referee approving a compromise can be set aside upon Review *only* by a showing of a clear abuse of discretion by the Referee, and not by showing that he may have erred in correctly anticipating the ultimate result of pending or threatened litigation. The very purpose of a compromise is to avoid the determination of sharply contested and dubious issues. The approval of a compromise is addressed to the sound discretion of the Referee, and his action thereon can be disturbed on Review only where the record shows a *clear abuse of discre-*

tion. This is true even where the order approves a compromise of a doubtful claim.

In *Matter of Prudence Co., Inc.,* 98 F. 2d 559, the Court states:

> "It is conceded, as it must be under the authorities, that the approval of a compromise of a claim against a bankrupt's estate is a discretionary order which can be reversed only for an abuse of discretion."

In *Scott v. Jones,* 118 F. 2d 30, the Court states:

> "An order approving a compromise of a doubtful claim involves the discretionary powers of the court and may be disturbed only when it clearly appears that such discretion has been abused."

To same effect: (*Matter of Anderson Thorson & Co.,* 125 F. 2d 325; *In re Riggi Bros. Co., Inc.,* 42 F. 2d 174; *Petition of Stuart,* 272 Fed. 938; *Drexel v. Loomis,* 35 F. 2d 800.)

(j) In approving a compromise the Referee *need not, and cannot* determine on the merits the controversy between the parties. It is the very purpose of a compromise to avoid a determination of sharply contested or even dubious issues. The primary factors to be considered are the probabilities of success or failure of litigation; the complexities of the litigation involved, or threatened, and the expense, delay and inconvenience of litigation. It is not the duty or province of the Court to make an actual determination on the merits of the controversy involved.

In *In re Riggi Bros. Co., Inc.,* 42 F. 2d 174, a leading case, the Court states:

> "[1, 2] The approval of this compromise settlement is not to be tested wholly by what may now be

thought would have been the result of litigation to settle the respective claims of the parties. It is certain that litigation for that purpose would have been the inevitable result of a failure to compromise and equally certain that it would have made for delay and expense. This should be kept in mind in reviewing the approval of the compromise. Petition of Stuart (C. C. A.), 272 F. 938-941. Coupled with the certainty of litigation was the uncertainty of its result and the soundness of the exercise of discretion in approving it largely depends upon how substantial was this element of uncertainty. The action of the District Court is presumptively right, and will not be set aside unless clearly shown to have been wrong. Pullman Couch Co. v. Eshelman (C. C. A.), 1 F. (2d) 885, 887, 888. Consequently, we shall make no attempt to decide with exactness what would have been the outcome had no settlement been made and approved. Any virtue which may reside in a compromise is based on doing away with the effect of such a decision. For present purposes it is enough to consider only what was reasonably to be expected to happen had no agreement been made. . . .

We do not decide what effect, if any, this Vermont statute would have had on the validity of the mortgage. It is quite enough now to know that the trustee would have met with serious opposition in trying to free the property from the mortgage lien. While he might, perhaps, have succeeded, the nature of the legal problems involved was such that the expense, delay and likelihood of failure may well have made a compromise settlement advisable."

In *Matter of the Prudence Co., Inc.,* 98 F. 2d 559, the Court states:

> "The District Court did not determine the validity of the government's claim with respect to the taxability of the 'commissions'; nor need this court do so. The very purpose of a compromise is to avoid the determination of sharply contested and dubious issues, . . ."

The Supreme Court of California, in *Mueller v. Elba Oil Co.,* 21 Cal. 2d 188, states:

> "Under this section the bankruptcy court had power to dispose of claims or assets of the bankrupt, of doubtful value, in an expeditious manner, other than in the usual and ordinary manner . . .
>
> In connection with the attack on the compromise proceedings, it is asserted that the trustee was entitled as of course to compel the defendants to marshal their assets, and on that premise plaintiff contends that there was no controversy to compromise. Such contention is devoid of merit; substantially every fact disclosed in connection with the proceeding to marshal assets and to compromise the same belies it. The mere fact that the trustee had the right as of course to maintain the proceedings did not make the fact or amount of net recovery for the partnership estate any less controversial. The trial court in bankruptcy (the referee) had the right to consider the uncertainty and cost of litigation in determining the advisability of compromise (*Petition of Stuart,* (1921, 6 Cir.) 272 F. 938, 941). . . ."

In *Matter of Anderson Thorson & Co.,* 125 F. 2d 325, the Court states:

> "Furthermore, we, as well as the District Court, are powerless in the instant situation to review the proceedings of that case. In fact, any error committed is irrelevant to the present question except as it might enter into the court's appraisement as to whether a compromise was better for the estate than the dubious result which might be achieved by appeal."

(To same effect: *Petition of Stuart,* 272 Fed. 938; *Drexel v. Loomis,* 35 F. 2d 800.)

It is a cardinal rule that a Referee speedily should dispose of litigation on behalf of the bankrupt estate, involving delay and expense. (*Scott v. Jones,* 118 F. 2d 30.)

Fortified with the foregoing principles of law it appears that the basic question (and only one) which the District Court could determine upon the Petition for Review was whether there was a clear showing that the Referee, in approving the compromise between the Receiver and Wil-Rud, had abused his discretion.

Viewed against the backlog of surrounding circumstances, it clearly appears that no abuse of discretion by the Referee was shown, and that the reversal of the Referee's Order Approving Compromise by the District Court was and is clearly erroneous. The evidence clearly shows that the Receiver's representative admittedly had delivered an inventory of assets to Rudolph, Wil-Rud's representative, shortly before the sale, and had given it to other bidders [R. 86-87]; that the business had been operated by Receiver, whose representative stated to Rudolph, "naturally there would be adjustments on the merchandise that had been used in connection with the operation of the

business." No specific items were mentioned. [R. 89.] Wil-Rud's representative was given the inventory about ten days before the sale and from an inspection of the plant could not discover any shortages, and was told that the only shortage was some grape juice. [R. 99.] At the sale a certain Miller bid of $135,000 was read to the Referee "for all outstanding shares of Yankee Doodle Root Beer Company and for the physical assets of California Associated Products," including all trade names, trade marks, formulas, registered trade names, lessee's interest in the lease, and insurance on a pro-rata basis, which excluded only the security held by the Bank of America, cash on hand, accounts and notes receivable and deposits. Title to the said property was to be delivered free and clear, except a water softener. *No other exclusions were mentioned.* [R. 51-53.] The Referee was advised that the Creditor's Committee had approved this bid and requested that it be accepted and that the Receiver be directed to sell without competitive bidding. [R. 29, 30, 53, 54.] Wil-Rud purchased all the assets for $161,000 [R. 30, 68] free and clear of all liens, charges and incumbrances [R. 4, 53]; and the Referee's Order Confirming Sale provided that the Receiver sold "all inventory," together with "all other physical assets . . . wheresoever situated," "free and clear of any liens, charges and incumbrances." [R. 4-5.] After confirmation the assets delivered were checked against the items on the original inventory by representatives of Receiver and Wil-Rud [R. 84-86], and the shortages were indicated upon a statement [R. 81-83] amounting to $18,952.16. Thereafter disputes arose between Receiver and Wil-Rud; a hearing was had before the Referee [R. 72-113], and evidence disclosing the foregoing was adduced as well as

that showing that Rudolph had purchased goods at bankruptcy sales for many years and always could rely upon Receiver's and Trustee's inventories, and that any shortages were *always* adjusted. [R. 100.] The Referee at this hearing stated that the inventory never would have been shown to Wil-Rud's representative, or even prepared "if they did not expect you (Wil-Rud) to rely on it" [R. 107], and that "I think a man ought to get what he buys, what he bids for. If he doesn't get it he should not pay for it" [R. 112]; and directed an order to be prepared accordingly. [R. 112.] The Referee's Certificate on Review states that Wil-Rud had submitted its bid in reliance upon the inventory admittedly shown its representative [R. 31]; that after the hearing of the evidence, the Referee was convinced that Wil-Rud had relied upon the inventory in making its bid [R. 33]; that he (the Referee) would rule that the purchase had been made pursuant to the inventory. [R. 31.] At this hearing the Referee's attention also was directed to the 60 cent deposits on thousands of wooden cases in the possession of customers which Wil-Rud had purchased "free and clear." [R. 112.] It was then suggested that Wil-Rud and Receiver attempt to adjust the matters, and if this could not be done, then appropriate proceedings would be commenced. [R. 113.] The evidence at the hearing on the Petition to Compromise disclosed that there was an item on page 88-A of the inventory representing 25,807 wooden cases with nothing to indicate that those cases were subject to a deposit of 60 cents per case paid by customers to the

Debtor [R. 127], and Receiver had not delivered this property to Wil-Rud "free and clear." [R. 169.] It was necessary to refund this deposit when empty cases were returned [R. 133, 142, 143]; that an empty case could not be picked up from the customer unless the driver gave him the 60 cents [R. 143]; that this had been the practice of both the Debtor and Receiver while operating the business. [R. 143.] The liability of the Receiver on the deposits could run over $16,000. [R. 125.] The Order Confirming Sale provided that all items were sold "free and clear of any liens, charges and incumbrances." [R. 5.] The Referee's Certificate on Review stated that the property had been sold free and clear, and that by reason of said deposits there was a strong possibility that the Receiver could not deliver clear title to the wooden cases and bottles involved without compensating the customers to the extent of 60 cents per case, as the customers had possession of the cases and appeared to be entitled to a lien thereon until the 60 cent deposit was returned. In addition thereto the Referee stated that there was the practical problem of quieting title to many thousands of wooden cases located in the hands of many thousands of customers. [R. 34.] All of the foregoing was before the Referee when he considered the advisability of the compromise. The Receiver was faced with a dilemma. The Referee previously had indicated that he would rule adversely to the Receiver upon the inventory shortages. Such a ruling admittedly would have entitled Wil-Rud to relief. It could have rescinded the sale, or it was entitled

to an abatement of a part of the purchase price, which the Referee had indicated he would allow. The Order Confirming Sale provided that payment was *concurrent* with delivery of all assets to Wil-Rud. The Receiver was required to deliver 25,807 wooden cases wheresoever situated, "free and clear," which were subject to deposits. To comply with the Order, a myriad of proceedings would have to be instituted by Receiver against customers who had paid a deposit of 60 cents per case to the Debtor, and having possession of the cases, in equity and good conscience, could assert a lien upon, or possessory rights to the cases until the deposit was returned; or they could assert refund claims or offset rights against the Receiver's estate. This liability could well exceed $16,000. No one could foretell with certainty the results of litigation between the customers and Receiver. The cost of such litigation involved a long delay, tremendous work and expense, and ultimately the Receiver probably would have to repay the deposits before he could deliver the cases to Wil-Rud "free and clear." Wil-Rud was willing to hold the Receiver harmless from these deposit refunds. Furthermore, the Referee had indicated a ruling adverse to the Receiver upon the question of inventory shortages. All these were matters which the Receiver, and ultimately the Referee, had to consider in determining whether the compromise was "for the best interests of the estate." *There was no abuse of discretion in approving the compromise. The reversal of the Referee's Order by the District Judge is erroneous.*

II.

The District Court Erred in Determining on the Merits the Controversies Between Receiver and Appellant. This Was Not Proper Upon the Petition for Review of Referee's Order Approving Compromise, as It Was Beyond the Power of the Court, and Deprived Appellant of Its Day in Court on Those Issues.

The District Court determined the existing controversies on the merits. [R. 44-48.] *Upon review* it had neither the right nor power to so do. Those were matters for future litigation, if the compromise failed.

The purpose of a compromise is to avoid the determination of sharply contested and dubious issues. (*Matter of the Prudence Co.,* 98 F. 2d 559; *In re Riggi Bros. Co.,* 42 F. 2d 174, 175.)

The authorities, as well as common sense, dictate that on a petition to compromise the Court can make no determination on the merits of the controversies sought to be compromised, for a decision upon the merits would leave nothing left to compromise. Certainly the District Court reviewing a Referee's order approving a compromise cannot make such a determination.

In the *Matter of Anderson Thorson & Co.* (7 Cir.), 125 F. 2d 325, the objecting creditor contended that it was error to approve a compromise of a judgment, pending an appeal therefrom, before determining the merits of the controversy on the appeal. The Circuit Court rejected such contention, stating:

> "Furthermore, we, as well as the District Court, *are powerless in the instant situation to review the proceedings of that case.* In fact, any error com-

mitted *is irrelevant to the present question* except as it might enter into the court's appraisement as to whether a compromise was better for the estate than the dubious result which might be achieved by appeal." (Italics ours.)

In the *Matter of the Prudence Co., Inc.,* 98 F. 2d 559, it was contended that it was error to approve a compromise of the Government's claim for income taxes before determining the validity of the claim. The Circuit Court answered that contention stating:

> *"The District Court did not determine the validity of the government's claim with respect to the taxability of the 'commissions'; nor need this court do so. The very purpose of a compromise is to avoid the determination of sharply contested and dubious issues,* . . ." (Italics ours.)

In *In re Riggi Bros., Inc.* (2nd Cir.), 42 F. 2d 174, it was contended that it was necessary to determine the validity of the mortgage involved therein before approving any compromise. In answer to that contention the Court stated:

> "Consequently, we shall make no attempt to decide with exactness what would have been the outcome had no settlement been made and approved. *Any virtue which may reside in a compromise is based on doing away with the effect of such a decision.* For present purposes it is enough to consider only what was reasonably to be expected to happen had no agreement been made. . . .

"We do not decide what effect, if any, this Vermont statute would have had on the validity of the mortgage. It is quite enough now to know that the trustee would have met with serious opposition in trying to free the property from the mortgage lien. . . ." (Italics ours.)

In *Mueller v. Elba Oil Co.,* 21 Cal. 2d 188, it was contended that it was error to approve a compromise as the Trustee, as a matter of law, could have prevailed in another proceeding available to him. The California Supreme Court stated:

"Such contention is devoid of merit; substantially every fact disclosed in connection with the proceeding to marshal assets and to compromise the sale belies it. The mere fact that the trustee had the right as of course to maintain the proceeding did not make the fact or amount of net recovery for the partnership estate any less controversial. . . ."

To same effect: (*Petition of Stuart,* 272 Fed. 938; *Drexel v. Loomis,* 35 F. 2d 800.)

In the instant case the Referee found that Wil-Rud reasonably could contend that it was entitled to an adjustment of $28,000, but made no actual determination of the existing controversies. [R. 21.] This was correct under the authorities.

The District Court *on review,* however, determined on the merits the existing controversies. This Order was and is beyond the power of the Court and error.

III.

The District Court in Reviewing the Referee's Order Approving Compromise Erred in Trying the Factual Questions De Novo, and in Rejecting the Referee's Findings, His Determination of the Credibility of Witnesses, and the Weight He Accorded to the Evidence.

The District Judge summarily rejected the Findings of the Referee [R. 45] and tried the *factual* questions involved *de novo* as though the matter had been tried before him in the first instant. In so doing the District Judge *on review* erroneously disregarded the Referee's determination as to credibility of witnesses and the weight he accorded to the evidence.

On July 29, 1947, by Order of Reference this entire Debtor Proceedings, out of which this instant matter arose, was referred *for all purposes* to Referee Hugh L. Dickson. [R. 179.] After such general reference, the *power* of the District Court was *strictly one of review.* (*In re Orpheum Circuit* (D. C. N. Y.), 20 Fed. Supp. 101.)

General Order No. 47 (U. S. C. A., Title 11, foll. Par. 53) provides:

> "Unless otherwise directed in the Order of reference the report of a referee . . . shall set forth his findings of fact and conclusions of law and the Judge shall accept his findings of fact unless clearly erroneous. . . ."

This Ninth Circuit Court of Appeals in *Powell et ux v. Wumkes,* 142 F. 2d 4, 6, has interpreted General Order 47 and the powers of a District Judge on review. This Court states:

> "Where he confines himself to a review of the record made before the referee he is not permitted to

> try factual questions *de novo,* that is to say, he is not at liberty to reject the findings of the referee merely because he disagrees with the latter as to the credibility of witnesses or the weight to be accorded conflicting evidence."

The District Court upon review is not justified in disregarding the Referee's findings when based upon substantial evidence. (*Reich v. Industrial Com'r of N. Y.* (2 Cir.), 145 F. 2d 759; *In re Freelove* (D. C. Cal.), 74 Fed. Supp. 666; *Ashton v. Sentney* (9 Cir.), 145 F. 2d 719; *In re Cummings* (D. C. Cal.), 84 Fed. Supp. 65.) Particularly is this so where there is conflicting evidence. (*Powell v. Wumkes* (9 Cir.), 142 F. 2d 4; *In re Nay* (D. C. Cal.), 58 Fed. Supp. 960; *Gentry v. Abbott-Kinney Co.* (D. C. Cal.), 66 Fed. Supp. 841.)

The Court of Appeals when considering findings of the District Court, made on review, contrary to those of the Referee upon matters referred to him for decision, has the same duty as the District Court to accept Referee's findings. (*Phillips v. Baker* (5 Cir.), 165 F. 2d 578; *In re Sandows* (2 Cir.), 151 F. 2d 807.)

The following Referee's Findings, based either upon undisputed substantial evidence, or conflicting evidence, was rejected by the District Court, namely, that Wil-Rud could reasonably claim a total adjustment of $28,000 against Receiver; that it was for the best interests of the estate to compromise [R. 21]; that the purchaser relied upon the inventory prepared by the estate in making its bid, and was entitled to pro-rata credits for shortages; that it would

be an unwise expense to direct the Receiver to quiet title to approximately 25,000 cases so that Receiver could deliver same to Wil-Rud, free and clear [R. 22-23]; that as a part of the compromise Wil-Rud agreed to hold Receiver harmless from the 60 cent refunds per case. [R. 22.]

The District Court also rejected the following statements in the Referee's Certificate, based upon substantial evidence, and the weight and credence given to it by Referee, namely, that Wil-Rud had submitted its bid in reliance upon the inventory admittedly shown its representative [R. 31, 33]; that after a hearing the Referee had indicated he would rule that the purchase was made pursuant to inventory, and a pro-rata allowance would be made to the bidder [R. 31, 33]; that the physical assets had been sold free and clear to purchaser; that Receiver could not deliver title to the wooden cases without repaying the 60 cent per case to distributors who having possession were entitled to a lien until the refunds were paid [R. 34]; that considering the practical and legal problems involved, the possibility of adverse rulings, the costs, expense and delays of litigation, the compromise was approved. [R. 34.] The District Court, in retrying the practical issues, disregarded the weight and credence given the evidence by Referee, namely the testimony of witnesses Yates, Rudolph, and Wilder, the substance of which, with record references, is fully set forth prior hereto under Specification of Error No. 3.[10] The District Court erred in refusing to accept the Referee's Findings.

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[10]This specification is found on pages 37 to 39 of this brief.

IV.

The District Court Erred in Applying the Doctrine of Caveat Emptor to Appellant's Purchase. It Was Not Applicable Because (A) of the Express Provisions of Order Confirming Sale; (B) of Representations by Receiver's Agent; (C) of the Referee's Findings; (D) Appellant Was Entitled to Pro-Rata Abatement of Purchase Price for Shortages and Liens; (E) It Was Not Proper Issue on Review.

The District Court's Order [R. 48] erroneously was bottomed upon the doctrine of *caveat emptor*.

The Order Confirming Sale *expressly* provided that Receiver sold certain described property, including "all inventory" and "all other physical assets of Debtor Corporation wheresoever situated," and "that all said items are sold free and clear of any liens, charges and incumbrances." [R. 4, 5.] It further provided "delivery of the assets to be made upon signing of within Order, and *payment* therefor to be made *concurrently with delivery* to buyer." [R. 4.]

A. It is well settled that the doctrine of *caveat emptor* does not apply where the order confirming sale contains express warranties. (6 Rem. Bkrcy. 55; 4 Collier Bkrcy. 1588.)

The provisions of the Court's decree are controlling and the parties rights and obligations are fixed thereby. The purchaser is protected by the order or decree of Court.

In *In re United Toledo Co.* (6 Cir.), 152 F. 2d 210, the Court states:

> "In a judicial sale the Court is the real vendor. . . . In such a case the Court's decree is controlling upon the parties, and their rights and obligations are fixed thereby. . . . The purchaser at a judicial sale is protected by the order or decree of the court, and he need not look beyond the decree . . ."

In *American Dirigold Corp. v. Dirigold Metals Corp.* (6 Cir.), 125 F. 2d 446, the Court states:

> "It is characteristic of a judicial sale, that the court's decree specifically describe the property to be sold. . . . Under this rule it becomes immaterial as to what statements of exclusion, if any the receiver made at the sale."

The Order Confirming Sale included "all inventory," and after a hearing the Referee found that it meant all items upon the inventory shown by Receiver's agent to Wil-Rud's representative. [R. 86, 99, 169, 22, 31, 33.] This was binding upon the District Court. The finding that the assets were sold on an "as is" basis without warranty finds no support. No *such exclusion* was in the Order Confirming Sale. Any such statement, if made, *becomes immaterial* under the foregoing authorities. After Wil-Rud's bid was accepted, Receiver's attorney sought to include additional terms, which Wil-Rud's attorney rejected. [R. 69.] The Receiver's attorney's attempts met no success, for the Referee in summing up his remarks

did not consider that the sale had been on an "as is" basis, and stated:

> "I think practically all you have said, and as I understood it thoroughly, is that these bidders are not buying the accounts receivable and they are not taking over the cash, but that they were getting the lease in, as and when they were getting it." [R. 70.]

Even if Receiver's attorney so intended, the Order Confirming Sale did not so state, and the Referee after a hearing found against such contention. This the District Court could not disregard.

B. The doctrine of *caveat emptor* does not apply when representations are made to bidder as to quantity, and he is misled thereby to his detriment, whether such representations were fraudulently, wilfully or ignorantly made. (*Webster v. Howorth,* 8 Cal. 21, 26; 15 Cal. Jur. 307; 50 C. J. S. 648, 654.)

The undisputed evidence discloses that the Receiver's agent gave Wil-Rud's representative an inventory [R. 86-87] and told him "naturally there would be adjustments on the merchandise that had been used in connection with the operation of business" [R. 89]; that it was impossible to discover shortages from an inspection of the plant. [R. 99.] The Referee found that Wil-Rud had relied upon the inventory and that it had a right to rely thereon, and was entitled to credit for shortages. [R. 22, 31, 33.]

C. It is also well settled that where a sale has been made under certain representations by trustee, or receiver,

the Referee is justified in allowing deductions from the purchase price for shortages and for liens or charges where the property is sold free and clear, and the rule of *caveat emptor* is not applicable.

In 6 Rem. Bkrcy. 66, ¶2572, 60, 4th Ed., the author states:

> ". . . where the sale has been made under representations by the trustee, the Court may be justified in allowing deductions from the purchase price for shortages, etc."

(To same effect: 50 C. J. S. 626; 35 C. J. 56; *Young & McWhorter v. Smith* (W. Va.), 107 S. E. Rep. 110, 113, 114; *Gen. Electric Co. v. Interstate Electric Co.,* 201 Mo. App. 22, 209 S. W. Rep. 562; *Cypress Lumber Co. v. Tillar & Wilson,* 73 Ark. 354, 84 S. W. 490; *Hall v. McGehee* (5 Cir.), 37 F. 2d 854, 855; *Searcy v. McChord,* 1 Fed. 261.)

The evidence shows that 25,807 cases, in the possession of customers, were subject to deposits, and could not be delivered "free and clear." [R. 143.]

In view of all the foregoing, and that negotiations were pending for several weeks between Wil-Rud and Receiver the Referee properly allowed the reductions on the purchase price by way of compromise. *Caveat emptor* did not apply.

V.

The District Court Erred in Holding That Since No One "Claimed a Lien" There Were No Liens or Charges Against the Wooden Cases. The Undisputed Evidence Shows a 60 Cent Deposit on Each Case Was Paid by Customers Which Had to Be Refunded Before Possession of the Cases Could Be Obtained. Besides, It Was Not a Proper Issue to Determine on Review.

The District Court concluded there was "no evidence that anyone had ever claimed a lien against the property purchased"; therefore there were no liens. The *undisputed* evidence shows that a 60-cent deposit had been given by customers on each case [R. 129, 133, 143], which was not indicated upon the inventory [R. 127]; that customers were entitled to this refund [R. 142-143]; that the empty cases could not be picked up from customers without refunding the 60 cents [R. 143, 144]; that such was the practice of Debtor and Receiver while operating the business [R. 143], which Wil-Rud would have to continue, if it wanted the cases [R. 144]; that on each case was a notation indicating a 60-cent deposit thereon [R. 146]; that the property was sold "free and clear" [R. 5]; that the Referee found that the cases could not be delivered "free and clear," and in his Certificate stated that it appeared customers had a lien, dependent upon possession until the refunds were paid. [R. 34.]

The *fact,* and not the *claim* of lien, determines whether one exists. Even though no customer stated, "I claim a lien on the cases," that did not disprove that one existed. The customers demanded the refund before they allowed the driver to pick up any case. [R. 142-144; 34, 23.]

This was sufficient to establish a lien, dependent upon possession.

At common law a lien consisted in the right to retain possession of the property of another until some debt or charge in connection therewith was repaid. (16 Cal. Jur. 302-3; *City of San Diego v. Higgins,* 115 Cal. 170, 178; *Quist v. Sandman,* 154 Cal. 748, 755; 53 C. J. S. 826.)

Under California statute a lien is defined as "a charge imposed in some mode other than by a transfer in trust upon specific property by which it is made security for the performance of an act." (Cal. Civ. Code, Sec. 2872; *Grey v. Horne,* 48 Cal. App. 2d 372, 375.) In connection therewith *Grey v. Horne, supra,* states:

> " 'In its broadest sense and common acceptation, it is understood and used to denote a legal claim or charge on property, either real or personal, as security for the payment for some debt or obligation. . . . It includes every case in which personal or real property is charged with the payment of a debt.' (37 C. J. 306.)"

As stated in *Quist v. Sandman, supra,* the statutory lien is "but declaratory of the common-law rule and the right to a lien must be governed by the same rules which prevailed at common law. It can only be asserted under the same circumstances and conditions as it could be asserted at common law and the right to do so must be interpreted in accordance with common-law principles." (154 Cal. 748, 755.)

A lien is but an accessory to and an incident of the debt, charge or obligation for which it is security. (Cal. Civ. Code 2809.) Redemption from a lien is made by

performing, or offering to perform the act for the performance of which it is security. (Cal. Civ. Code 2905.)

Most certainly the customers had a common law, as well as statutory lien, dependent upon possession, upon the cases, until the deposits were repaid. It was not necessary to make a "claim a lien" as such, as long as they asserted the right to the refund and retained possession of the cases until the refund was paid. (*Perot's Estate v. Perot,* 148 So. 903, 177 La. 640; *Faulkner v. Harding,* 9 Mo. App. 12.)

If the transaction between Debtor and customers regarding the cases was one of bailment, the customers, as bailees, having deposited 60 cents per case, had a lien upon the cases, dependent upon possession, until the deposits were refunded. (Cal. Civ. Code 1833, providing "a depositor must indemnify the depository . . . For all expenses necessarily incurred by him . . ."; and Cal Civ. Code 1856, providing that a depository has a lien for charges, and for all moneys advanced or expended; 4 Cal. Jur. 26-27.)

The fact that the property was sold "free and clear" would not transfer the customers' liens from the cases to the proceeds. The customers were not before the Court, and the cases were in *their* possession.

As stated in *Matter of Orpheum Circuit, Inc.* (D. C., N. Y.), 20 Fed. Supp. 101:

> "Since most of the assets were in the possession of an adverse claimant under claim of pledge that was more than mere colorable, the bankruptcy court had no power to sell the assets free and clear of liens."

Further the issue of the validity of the liens of the customers was not before the District Court upon review, and no determination thereof should have been made. It was sufficient to know that the Receiver would have met with serious opposition in trying to obtain possession of 25,807 cases, without repaying the 60 cent per case deposit. (*In re Riggi Bros. Co., Inc.,* 142 F. 2d 174; *Matter of the Prudence Co., Inc.,* 98 F. 2d 559; *Matter of Anderson Thorson & Co.,* 125 F. 2d 325.)

VI.

The District Court Erred in Holding That the Petition to Compromise Was a Collateral Attack Upon Order Confirming Sale. Appellant Showed Non-Compliance by Reciever With Terms of Order, Entitling It to Reduction in Purchase Price, Which Was Proper Subject of Compromise.

The Order Confirming Sale provided that Receiver sold *all inventory* together with *all other* physical assets of Debtor *wheresoever* situated, *free and clear* of any liens charges and incumbrances, and that *payment* of the purchase [R. 4-5] price was to be made *concurrently* with delivery of assets.

Appellant claimed that all the property purchased was not delivered in that there were $18,952.16 in inventory shortages [R. 81-83], and that 25,807 wooden cases in possession of customers were not "free and clear" but subject to deposits amounting to over $16,000. [R. 125.] The Referee, after hearing evidence, found there were

shortages and liens for which appellant would be entitled to pro-rata reduction. [R. 21-24, 31, 33, 34.]

The Court always has the right to determine if the purchaser received everything he was entitled under the decree. (*In re United Toledo Co.* (6 Cir.), 152 F. 2d 210.)

Where a sale has been made under representation of trustee of Receiver, the Court is justified in allowing deductions from the purchase price for shortages, and such has never been considered a collateral attack. (6 Rem. Bkrcy. 66.)[11]

The Referee having determined that there were shortages and liens, that Receiver could not comply with the Order Confirming Sale, appellant was entitled to a pro rata deduction. Payment having been made *concurrent* with *delivery,* the Receiver was *not* entitled to his money until appellant's claims were adjusted. A compromise was a proper procedure. The authorities under Point I so hold. It was a speedy and expeditious procedure. Certainly it was not a collateral attack. It was common sense, and the very purpose for which the compromise statute (U. S. C. A., Title 11, Sec. 50) was enacted. To hold otherwise was error.

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[11]See page 71 of Brief where authorities are collated.

VII.

The District Court's Findings and Order, in Material Matters, Are Not Supported by the Evidence and Are Contrary Thereto, and Cover Many Matters Not Proper Issues Upon Review.

The District Court, in reviewing a Referee's order approving a compromise, is limited to *the record* before the Referee and cannot accept argument by, or statements of counsel as evidence. (*In re Paley,* 26 Fed. Supp. 952.) Evidence not taken or admitted before the Referee cannot be considered on review. (*In re Panamer Realty Corp.,* 54 Fed. Supp. 656.)

Under Specifications of Error, Nos. 4 to 7, inclusive, the District Court's Findings in certain particulars have been challenged. They are the following:

(a) That portion of Finding No. 1, reading as follows:

> ". . . A bidder offered $160,000 and thereupon a bid of $161,000 was made on the same terms by the Wil-Rud Corporation 'for all of the outstanding shares of Yankee Doodle Root Beer Company and for the physical assets of California Associated Products . . .' . . ." [R. 45.]

(b) That portion of Finding No. 2, reading as follows:

> ". . . That said inventory does not purport to be other than an inventory made as of July 28, 1947. That this fact was made known to all bidders. That at the time of the sale the said assets were offered 'as is' and without any warranty as to quantity or quality and without any reference to an inventory. That immediately after the confirmation of the sale, the assets so sold were delivered to the Wil-Rud Corporation. . . ." [R. 46.]

(c) Finding No. 4, reading as follows:

"4. That said sale was not made on the basis of a sale of the assets as reflected in the receiver's inventory as of the close of business on July 28, 1947, nor was the bid of Wil-Rud so made." [R. 47.]

(d) Finding No. 5, reading as follows:

"5. That the said Will-Rud Corporation was not warranted in relying upon nor did it rely upon the inventory in making said bid. That it was not in the best interests of creditors that the said proposed compromise be ordered." [R. 47.]

The summary of the evidence in connection with each of the foregoing Findings, together with record references, is set forth under Specifications of Error Nos. 4-7, inclusive, and is incorporated hereunder by this reference to save space and needless repetition.[12]

These Findings in their *entirety* are based upon the *statements* and *arguments* of appellees' counsel in the proceedings below, *and not upon any competent evidence before the Referee, or District Court.* The evidence is to the contrary. Such arguments and statements could not be accepted by the District Court as evidence.

Upon competent evidence the Referee found, that Wil-Rud's bid was made in pursuant to and in reliance upon an inventory admittedly shown its agent by Receiver representative, who stated that adjustments for assets used would be made [R. 86, 87, 89, 107, 21, 22, 31-33]; that the inventory shortage was $18,952.16 [R. 81-83]; that

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[12]See brief pages 39 and 40 for summary of evidence for Finding No. 1; pages 40 to 42 for Finding No. 2; pages 42 and 43 for Finding No. 4; pages 43 to 46 for Finding No. 5.

there were 60 cents per case deposits upon 25,807 wooden cases, amounting to over $16,000 [R. 125, 142, 143], which appeared to be a lien thereon [R. 22, 34]. The objecting creditors never offered any evidence to the contrary, or otherwise. At the hearing on November 7, 1947, Receiver's counsel strenuously *argued* that the assets had been sold "as is" but the record belied that contention and the Referee found to the contrary [R. 21, 23, 31, 33.] After Wil-Rud's bid at the sale had been accepted, Receiver's counsel attempted to inject such condition, which was rejected [R. 68-69]. The Referee then stated to Receiver's counsel, "I think practically all you have said, and as I understood it thoroughly, is that these bidders are not buying the accounts receivable and they are not taking over the cash but that they were getting the lease in, as and when they were getting it" [R. 70]. Counsel's argument is *not evidence;* if the statements at the sale contradicted the testimony adduced at this hearing (and it does not), the Referee's finding adverse to Receiver is binding. The "as is" theory again was invoked *by way of argument* [R. 165] at the compromise hearing, but no evidence in support thereof was offered. There is no evidence that Wil-Rud's bid was not based upon the inventory, or that it did not have a right to rely thereon. The evidence is to the contrary. Findings which purport to determine the merits of controversies existing between the Receiver and Wil-Rud were not proper issues to determine upon Review. The District Court's Findings and Order are contrary to, and not supported by, the evidence.

Conclusion.

We respectfully submit that the record is replete with prejudicial, reversible error, which materially affect Appellant to its prejudice. We therefore respectfully submit that the Order of the District Court be reversed with directions to affirm the Referee's Order approving the compromise, together with appellant's costs of appeal.

Respectfully submitted,

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